EDITOR'S NOTE

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No. 84-889-CFX
Status: GRANTED

Title: California and Public Utilities Commission of California, et al., Petitioners
v.
Federal Communications Commission and United States

Docketed:
December 10, 1984

Court: United States Court of Appeals for the Fourth Circuit

Vide:
84-1069
84-1054
84-871

Counsel for petitioner: Kerr, Janice E., Rodgers Jr., William Paul, Davenport, Howard C., Bello, Carla Vivian, Keskey, Don L., Gundling, William B., Nugert, Patrick J., Shifman, Joel B.

Counsel for respondent: Kramer, Albert H., Solicitor General, McKenna, Richard, Boudin, Michael, Bartlett, John L., Hill, Carolyn C., Bilenky, William S., McG. Rose, Donald

Entry	Date	Note	Proceedings and Orders
1	Dec 10 1984	G	Petition for writ of certiorari filed.
2	Dec 10 1984		Appendix of petitioners CA, et al. filed.
4	Dec 20 1984		Order extending time to file response to petition until January 16, 1985.
5	Jan 8 1985		Order further extending time to file response to petition until February 4, 1985.
7	Jan 16 1985		Order extending time to file response to petition until February 15, 1985.
8	Jan 17 1985		Brief amicus curiae of Maine, et al. filed.
9	Jan 22 1985		Order extending time to file a single joint response or multiple responses to the petition until February 15,
10	Jan 22 1985		1985.
11	Feb 13 1985		Order further extending time to file response to petition until March 3, 1985.
12	Feb 13 1985		Above extension is for all private respondents.
13	Feb 15 1985		Order further extending time to file response to petition until March 18, 1985.
14	Feb 15 1985		Above extension is for the Solicitor General.
15	Mar 18 1985		Brief of respondents GTE Serv. Corp., et al. in opposition filed. VIDED.
16	Mar 19 1985		Brief of respondents FCC, et al. in opposition filed. VIDED.
17	Mar 18 1985		Brief of respondents AT&T, et al. in opposition filed. VIDED.
18	Apr 4 1985		Reply brief of petitioners CA, et al. filed.
19	May 28 1985		DISTRIBUTED. June 13, 1985.
20	Jun 14 1985		REDISTRIBUTED. June 20, 1985.
21	Jun 24 1985		Petition GRANTED. The case is consolidated with No. 84-871, Louisiana Public Service Commission v. Federal Communications Commission; No. 84-1054, Public Utilities Commission of Ohio v. Federal Communications Commission; No. 84-1069, Florida Public Service Commission v. Federal Communications Commission; and a total of one hour is allotted for oral argument. The cases are set

No. 84-889-CFX

Entry	Date	Note	Proceedings and Orders
			for oral argument in tandem with No. 84-1362, Public Service Commission of Maryland v. Chesapeake and Potomac Telephone Company of Maryland. Justice Powell and Justice O'Connor took no part in the consideration or decision of this order.
			**
23	Jul 3 1985		Order extending time to file brief of petitioner on the merits until September 9, 1985.
24	Jul 3 1985		Above extension is also for the joint appendix.
25	Sep 9 1985		Brief amicus curiae of Maine, et al. filed. VIDED.
26	Sep 9 1985	G	Motion of Telephone Ratepayers Association for Cost-based and Equitable Rates for leave to file a brief as amicus curiae filed.
27	Sep 6 1985		Brief amicus curiae of Alabama, et al. filed. VIDED.
28	Sep 9 1985		Brief amicus curiae of Natl. Conference of State Legislatures, et al. filed. VIDED.
29	Sep 9 1985		Brief of petitioners California, et al. filed. VIDED.
30	Sep 9 1985		Brief of petitioners LA, FL Public Serv. Commn. and OH PUC filed. VIDED.
31	Sep 9 1985		Brief amicus curiae of Louisiana, et al. filed. VIDED.
32	Sep 16 1985		Brief Joint appendix filed. VIDED.
33	Oct 7 1985		Motion of Telephone Ratepayers Association for Cost-based and Equitable Rates for leave to file a brief as amicus curiae GRANTED. Justice Powell and Justice O'Connor OUT.
34	Oct 9 1985		Brief amicus curiae of MCI Telecommunications Corp. filed. VIDED.
36	Oct 10 1985		Order extending time to file brief of respondent on the merits until November 12, 1985.
37	Nov 4 1985	G	Motion of the Solicitor General for divided argument filed.
38	Nov 12 1985		Brief amicus curiae of United States Telephone Assn. filed. VIDED.
39	Nov 12 1985		Brief of Listed Private Respondents filed. VIDED.
40	Nov 12 1985		Brief of respondents FCC, et al. filed. VIDED.
41	Nov 12 1985		Brief of respondents GTE Serv. Corp., et al. filed. VIDED.
42	Nov 19 1985		CIRCULATED.
43	Nov 21 1985		SET FOR ARGUMENT, Monday, January 13, 1986. (3rd case).
44	Dec 2 1985		Motion of the Solicitor General for divided argument GRANTED. Justice Powell and Justice O'Connor OUT.
45	Dec 5 1985		Record filed.
46	Nov 27 1985		Application for leave to file a reply brief in excess of the page limitation filed (A-423), and order granting
47	Nov 27 1985		same by Rehnquist, J., on December 3, 1985. The brief may not exceed 30 pages.
48	Dec 17 1985	X	Reply brief of petitioners CA, et al. filed. VIDED.
49	Dec 21 1985	X	Reply brief of petitioner LA Pub. Serv. Commn. filed. VIDED.
50	Dec 27 1985	X	Reply brief of petitioner Florida Public Service Commission filed. VIDED.
51	Jan 13 1986		ARGUED.

84-889 (1)

No.

In the Supreme Court

OF THE

United States

OCTOBER TERM, 1984

PEOPLE OF THE STATE OF CALIFORNIA AND PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA, et al.,
Petitioners,

vs.

FEDERAL COMMUNICATIONS COMMISSION AND UNITED STATES OF AMERICA,
Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

JANICE E. KERR*
General Counsel
J. CALVIN SIMPSON
Assistant General Counsel
GRETCHEN DUMAS
Principal Counsel
PEOPLE OF THE STATE OF CALIFORNIA AND THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA
350 McAllister Street
San Francisco, CA 94102
**Counsel of Record*
Telephone: (415) 557-0470

BOWNE OF SAN FRANCISCO, INC. • 190 NINTH ST. • S.F., CA 94103 • (415) 864-2300

37PP

David E. Blabey
General Counsel
Lawrence G. Malone
Counsel
Department of Public Service
of the State of New York
Three Empire State Plaza
Albany, New York 12223

Frank J. Kelley
Attorney General
Louis J. Caruso
Solicitor General
Don L. Keskey
Leo H. Friedman
Assistant Attorney General
The State of Michigan and
Michigan Public Service
Commission
1000 Long Boulevard, Suite 11
Lansing, Michigan 48910
Lynda S. Mounts
Cadwalader, Wickersham & Taft
1333 New Hampshire Ave., N.W.
Washington, D.C. 20036
Of Counsel

William Paul Rodgers, Jr.
General Counsel
Charles D. Gray
Assistant General Counsel
Genevieve Morelli
Deputy Assistant
General Counsel
National Association of
Regulatory Utility
Commissioners
1102 ICC Building
Post Office Box 684
Washington, D.C. 20044

Joel B. Shifman
Attorney
Public Service Commission
of West Virginia
State Capitol
Charleston,
West Virginia 25305

Jack Shreve
Public Counsel
Office of the Public Counsel
202 Blount Street, Room 624
Tallahassee, Florida 32301

Steven W. Hamm
Consumer Advocate for the
State of South Carolina
Raymond E. Lark, Jr.
Assistant Consumer Advocate
South Carolina Department
of Consumers Affairs
2801 Devine Street
Columbia,
South Carolina 29250

Susan W. Rester
Special Assistant
Attorney General
Minnesota Department of
Public Service
1102 Bremer Tower
7th & Minnesota
St. Paul, Minnesota 55101

David Lynch
Assistant General Counsel
Iowa State Commerce
Commission
1350 New York Ave., N.W.,
No. 1023
Washington, D.C. 20003

Brian Moline
General Counsel
James Flaherty
Attorney
Kansas State Corporation
Commission
State Office Building
Topeka, Kansas 66612

Howard C. Davenport
General Counsel
Lloyd N. Moore, Jr.
Moore & Hicks
1250 Eye Street, N.W., No. 201
Washington, D.C. 20005
Attorneys for Public Service
Commission of the District
of Columbia

Steven Schur
Chief Counsel
Jon Kingstad
Assistant Chief Counsel
Wisconsin Public Service
Commission
Post Office Box 7854
Madison, Wisconsin 53707

Robert Waldrum
Attorney
Arkansas Pulic Service
Commission
1000 Center
P.O. Box C-400
Little Rock, Arkansas 72202

Kenneth O. Eikenberry
Attorney General
Larry V. Rogers
Assistant Attorney General
Washington Utilities and
Transportation Commission
Highways-Licenses Building
Olympia, Washington 98504

Irwin I. Kimmelman
Attorney General of
New Jersey
By Alan S. Pralgever
Deputy Attorney General
for the New Jersey Board of
Public Utilities
Division of Law
1100 Raymond Blvd., No. 316
Newark, New Jersey 07102

JOSEPH I. LIBERMAN
Attorney General
WILLIAM B. GUNDLING
Assistant Attorney General
PETER J. JENKELUNAS
Assistant Attorney General
DEPARTMENT OF PUBLIC UTILITY
CONTROL/STATE OF
CONNECTICUT
1 Central Park Plaza
New Britain, Connecticut 06051

QUESTION PRESENTED

Has the Federal Communications Commission exceeded its authority to regulate interstate communications under Sec. 151 of the Communications Act, 47 U.S.C. Sec. 151, by preempting state authority to regulate the prescription of intrastate depreciation rates used in the setting of intrastate telephone rates?

LIST OF PARTIES

People of the State of California and the Public Utilities Commission of the State of California

Virginia State Corporation Commission

Federal Communications Commission and United States of America

North American Telephone Company

Florida Public Service Commission

State of Michigan and Michigan Public Service Commission

Department of Public Utility Control of the State of Connecticut

National Association of Regulatory Utility Commissioners

Southern Pacific Communications Company

Public Service Commission of the District of Columbia

Public Utilities Commission of Ohio

Arkansas Public Service Commission

Kansas State Corporation Commission

GTE Service Corporation

Public Service Commission of Wyoming

Continental Telecom Inc.

Washington Utilities and Transportation Commission

United Telephone System, Inc.

Department of Public Service of the State of Minnesota

Arizona Corporation Commission

Cincinnati Bell Inc.

Citizens of the State of Florida, Office of Public Counsel

National Association of State Utility Consumer Advocates

Consumer Advocate of South Carolina

Office of Consumers' Counsel for the State of Ohio

Iowa State Commerce Commission

Public Service Commission of Wisconsin

Public Service Commission of West Virginia

New York State Department of Public Service

The Bell Telephone Company of Pennsylvania

The Chesapeake and Potomac Telephone Company

The Chesapeake and Potomac Telephone Company of Maryland

The Chesapeake and Potomac Telephone Company of Virginia

The Chesapeake and Potomac Telephone Company of West Virginia

The Diamond State Telephone Company

Indiana Bell Telephone Company, Incorporated

Michigan Bell Telephone Company

The Mountain States Telephone and Telegraph Company

New England Telephone and Telegraph Company

New Jersey Bell Telephone Company

New York Telephone Company

Northwestern Bell Telephone Company

The Ohio Bell Telephone Company

Pacific Northwest Bell Telephone Company

The Pacific Telephone and Telegraph Company

Bell Telephone Company of Nevada

South Central Bell Telephone Company

Southern Bell Telephone and Telegraph Company

The Southern New England Telephone Company

Southwestern Bell Telephone Company

Wisconsin Telephone Company

Board of Public Utilities of New Jersey

Louisiana Public Service Commission

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No.

In the Supreme Court

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OCTOBER TERM, 1984

PEOPLE OF THE STATE OF CALIFORNIA AND
PUBLIC UTILITIES COMMISSION OF THE
STATE OF CALIFORNIA, et al.,
Petitioners,

VS.

FEDERAL COMMUNICATIONS COMMISSION AND
UNITED STATES OF AMERICA,
Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

Petitioners the People of the State of California and the Public Utilities Commission of the State of California (California), New York State Department of Public Service, State of Michigan and Michigan Public Service Commission, National Association of Regulatory Utility Commissioners, Public Service Commission of West Virginia, Citizens of the State of Florida—Office of the Public Counsel, Consumer Advocate of South Carolina, Department of Public Service of the State of Minnesota, Iowa State Commerce Commission, Kansas State Corporation Commission, Public Service Commission of the District of Columbia, Public Service Commission of Wisconsin, Arkansas Public Service Commission, Washington Utilities and Transportation Commission, Board of Public Utilities

of New Jersey, and Department of Public Utilities Control of the State of Connecticut respectfully pray that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Fourth Circuit entered on June 18, 1984.

OPINION AND ORDERS BELOW

The opinion of the United States Court of Appeals for the Fourth Circuit is set forth in Appendix A. The Federal Communications Commission's (FCC) December 22, 1982 Order preempting state prescription of depreciation rates is set forth in Appendix A. The FCC's April 27, 1982 Order which found that the FCC could not preempt state prescription of depreciation rates is set forth in Appendix A.

JURISDICTION

The Court of Appeals entered judgment on June 18, 1984. The Court of Appeals denied rehearing on October 3, 1984 (See Appendix A). The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATUTORY PROVISIONS INVOLVED

Relevant statutory provisions are set forth in Appendix B.

STATEMENT OF THE CASE

I

STATEMENT OF FACTS

In 1934 Congress enacted the Communications Act (Act), 47 U.S.C. 151 et seq. in which a dual federal state regulatory scheme was established. The Federal Communications Commission (FCC) regulates the interstate network and the states, the intrastate network. Sections 152(b), 47 U.S.C. § 152(b), and 221(b), 47 U.S.C. § 221(b), expressly

restrict the federal government from regulating the entire national network by preserving the states' intrastate jurisdiction. Specifically, they provide that, apart from radio licensing, "nothing in this act shall be construed to apply or give the Commission jurisdiction with respect to (1) charges, classifications, practices, services, facilities, or regulations for or in connection with intrastate communications service." [47 U.S.C. § 152(b)], or ". . . in connection with . . . telephone exchange service . . . even though a portion of such exchange service constitutes interstate or foreign communications". 47 U.S.C. § 221(b). Based on this reservation of jurisdiction to the states, state regulatory agencies have been prescribing intrastate depreciation expenses for regulated telephone companies for the last 50 years as part of their obligation to set intrastate rates. Under well established ratemaking principles states seek to prescribe rates that cover all intrastate operating expenses plus a fair rate of return on the rate base devoted to intrastate service. Depreciation expenses make up a significant percentage of the revenue requirement which the rates paid by intrastate customers are intended to satisfy.[1] *FPC v. Hope Natural Gas Co.*, 320 U.S. 591 (1944); *Lindheimer v. Illinois Bell Telephone Co.*, 292 U.S. 151 (1934); *Smith v.*

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[1]Until the instant case, the depreciation rates were set by grouping individual pieces of equipment together in units by vintage. Then service lives were set for these units. The setting of service lives was done in a three way meeting between the FCC, the telephone company and the state regulatory agency. State and federal authorities have not always agreed on service lives and have not been bound by these meetings. (See, N.Y. Tel. Co., Opinion 81-3, January 19, 1981.) The state or federal jurisdiction then applied its depreciation methodology to the portion of local plant allocated to it by the separations process. Approximately 75% of the investment in local plant is currently allocated to interstate services and about 25% to intrastate services. Each jurisdiction then came up with a dollar figure which was then included as part of the company's revenue requirement.

Illinois Bell Telephone Co., 282 U.S. 133 (1930). Over this 50-year period the FCC has interpreted the Act as allowing the states to prescribe their own depreciation policy for purposes of setting intrastate rates. See FCC April 27, 1982 Order, *In the Matter of Amendment of Part 31, Uniform System of Accounts for Class A and Class B Telephone Companies, Memorandum Opinion and Order*, 89 F.C.C. 1094 (1982) (April Order), rev'd, C.C. Docket No. 79-105, (F.C.C. January 6, 1983).

In the instant case, the FCC has reversed its earlier interpretation of the Act which it articulated as late as April 27, 1982 (See April Order). It now asserts that the task of introducing competitive market concepts into the regulated telecommunications industry necessitates the preempting of all state authorized depreciation and accounting methodologies used in the regulation of intrastate telecommunication services.

II
PROCEEDINGS BELOW

On August 14, 1979, the FCC issued a notice of proposed rulemaking which dealt with changes in accounting and depreciation procedures relating to the expenses incurred in connecting a telephone line to the telephone system. (Station connection account.)[2] On March 31, 1981 (March Order), the FCC issued an Order establishing expensing and amortization rules to replace depreciation procedures that had previously applied to the inside wiring portion of the station connection account.[3]

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[2]*In the matter of Amendment of Part 31, Uniform System of Accounts for Class A and Class B Telephone Companies, Notice of Proposed Rulemaking*, 44 F.R. 48988 (August 14, 1979.)

[3]*In the matter of Amendment of Part 31, Uniform System of Accounts for Class A and Class B Telephone Companies, First Order and Report*, 85 F.C.C.2d 818 (1981).

On April 20, 1981, the People of the State of California and the Public Utilities Commission of the State of California (California) filed a Petition for Reconsideration of this Order and on April 30, 1981 the National Association of Regulatory Utility Commissioners (NARUC) filed a Petition for Clarification. Both Petitions requested the FCC to clarify whether the March Order was intended to preempt states from prescribing depreciation rates and using accounting practices for intrastate communications which differed from those used by the FCC.

The American Telephone and Telegraph Company (AT&T) and GTE Service Corporation responded to these petitions by arguing that Congress had explicitly authorized the FCC to preempt the states under Section 220 of the Communications Act. AT&T and GTE Service Corporation further argued that, in any event, the FCC could prohibit states from relying on their own depreciation or accounting methods on the ground that such action would frustrate the accomplishment of federal policies and objectives.

After receiving comments from a diverse group of interested parties, the FCC issued its April Order, *supra*, in which it found that Section 220 of the Act did *not* authorize the FCC to preempt the states from using their own accounting and depreciation procedures for intrastate ratemaking purposes. The FCC also concluded that no valid federal policy would be frustrated if states employed their own accounting and depreciation practices In this regard, the FCC stated that "if carriers maintain the records we require for purposes of interstate ratemaking, federal regulations would not be frustrated if carriers maintain additional records for other purposes." 89 F.C.C.2d at 1097. The FCC herein acknowledged that states have for years kept separate records.

AT&T and GTE Service Corporation thereupon sought reconsideration of the April Order before the FCC and instituted a proceeding for judicial review in the United States Court of Appeals for the District of Columbia Circuit. *AT&T v. FCC*, Appeal docketed, Case No. 82-1747 (D.C. Cir. 1982) and *GTE Service Corporation v. FCC*, Appeal docketed, Case No. 82-1752 (D.C. Cir. 1982).

In response to the AT&T petition, the FCC reversed its earlier stand and adopted its *Memorandum, Opinion and Order* of December 22, 1982.[4] In that Order, the FCC found state prescription of depreciation rates and accounting practices which are inconsistent with those of the FCC to be preempted by Section 220 of the Communications Act, or, in the alternative, found that inconsistent state depreciation rates would impede the FCC's pro-competition policy and were, thus, preemptive.[5]

A petition for review of the December Order was filed in the Court of Appeals for the Fourth Circuit by the Virginia State Corporation Commission with California and numerous other state parties intervening.[6] The major points raised by the states were that state prescription of depreciation rates for intrastate service did not frustrate federal

[4]*In the Matter of Amendment of Part 31, Uniform System of Accounts for Class A and Class B Telephone Companies, Memorandum, Opinion and Order,* C.C. Docket No. 79-105, F.C.C. No. 82-581, slip. op. January 6, 1983, 48 Fed. Reg. 2324 (January 18, 1983) (December Order).

[5]After the FCC reversed itself, AT&T and GTE Service Corporation moved to dismiss their appeals. The District of Columbia Circuit granted their motion on March 31, 1983, terminating all pending appeals on the subject in that court. AT&T and GTE Service Corporation subsequently intervened in the instant case in support of the FCC.

[6]See list of parties signing this petition, *supra*.

policy and that Congress in the Act did not clearly and unmistakenly preempt the states from determining such rates.

On June 18, 1984, the Fourth Circuit found it unnecessary as a matter of law to determine whether Section 220 of the Act required preemption of the depreciation question by the FCC.[7] Instead, the court upheld the FCC on the ground that preemption was necessary to prevent frustration of the federal purpose contained in the preamble of the Act. 47 U.S.C. § 151.[8] The Court held that preemption was justified because "interstate communications would undoubtedly be affected by the states' imposition of depreciation policy . . .". *Virginia State Corporation Commission v. FCC, et al.*, 737 F.2d 388, 395 (4th Cir. 1984). The court went on to say that this case, unlike other preemption cases which involved jointly used plant, raised

> no question of actual physical impossibility of complying with dual federal and state regulation; presumably, the carriers could keep accounts in which its assets would be separately depreciated for intrastate and interstate purposes. Nonetheless, physical impossibility is but one ground for preemption; frustration of federal objectives provides a rationale at least equally valid. Since inconsistent state regulation poses an impediment to the development of interstate facilities, preemption is justified in this case even if "physical impossibility" is not at issue.

At 737 F.2d at 396.

[7]Arguments related to whether Section 220 clearly and unmistakenly calls for preemption will not be discussed in this petition since the Fourth Circuit did not address this point. See FCC's April Order, *supra*, which holds that Section 220 does not preempt state authority. Appendix A

[8]47 U.S.C. Sec. 151 states in part ". . . to make available . . . to all the people of the United States a rapid, efficient, Nationwide, and worldwide wire . . . communication service . . .".

As it made this historic move towards consolidating power in the federal government, the majority seemed less than confident about the true extent of the conflict between federal and state depreciation policies. The court stated that the policy conflict surrounding depreciation rates was "more attenuated than the very direct effect produced by physical connection of equipment to interchangeable lines . . .", 737 F.2d at 395, the situation present in the earlier preemption cases. Obviously, the court was referring to the fact that when separability is possible, as it is in the instant case, much of the potential for conflict is eliminated. Nevertheless, the court found that the FCC's pro-competition policies in the interstate market might possibly be frustrated if states continue to prescribe inconsistent depreciation rates. 737 F.2d at 395.

In contrast, the dissent found that there was no support in the record for the FCC's position and accused the FCC of manufacturing a conflict to justify its preemption of state jurisdiction. 737 F.2d at 398. For example, neither the Fourth Circuit nor the FCC at any time has explained 1) how capital recovery through depreciation mechanisms enhances competition in any particular market; 2) to what market the FCC's concern over competition relates; or 3) what the relationship was between capital recovery in the intrastate market and competition in the interstate market. The dissent concludes, that the FCC's

> . . . unsupported and unsupportable statements as to the effect on competition of inconsistent state depreciation methods, do not provide even a modicum of reasoned analysis supporting the FCC's decision to interfere in state ratemaking after several decades of affirmatively espousing the opposite conclusion.

737 F.2d at 399.

REASONS FOR GRANTING THE WRIT

I

THE DECISION BELOW RAISES AN IMPORTANT QUESTION OF FEDERAL LAW WHICH SHOULD BE SETTLED BY THIS COURT

When Congress enacted the Communications Act, it envisioned a dual federal-state regulatory scheme in which the FCC would regulate the interstate network and the states, the intrastate network. 47 USC §152(b); 47 USC § 221(b). Today, that congressional mandate is at risk. The FCC has taken the position that monopoly power, the basic economic premise which justifies regulation, is being eroded by competition and that a new regulatory scheme, which gives the FCC control over all regulatory policies related to competition for both interstate and intrastate services, must be created. Specifically, the FCC has extended its regulatory reach to the most basic mechanism by which states have regulated intrastate communications over the last 50 years, local rates. Currently, depreciation expenses, the specific issue in this case, make up 10% to 20% of the revenue requirement recovered in intrastate rates. This FCC action is a direct challenge to the jurisdiction reserved to the states under the Act. See 47 U.S.C. § 152(b) and 47 U.S.C. §221(b).

A. There Is No Conflict Between State Depreciation Policies and Federal Policies; the FCC Has Created a Rationale for Preemption Which Will Permit It to Abrogate Completely State Regulation of Intrastate Ratemaking in Violation of the Communications Act

Historically, states have had exclusive control over the setting of intrastate depreciation rates.[9] Until the instant

[9] In the process of setting these depreciation rates for intrastate service, states have frequently used a different depreciation methodology from that approved by the FCC for interstate telephone

case the FCC has never found that state deviations from its methodology frustrated federal policy. In fact, nine months before the decision at issue, the FCC itself concluded that no federal policy would be frustrated if state regulators continued their long-established policy of using depreciation and accounting methodologies for ratemaking purposes which differ from those used by the FCC. 89 F.C.C.2d at 1097.

Nine months later in the instant case, the FCC reversed its position and asserted that a conflict between state and federal policy existed and thus preemption was needed. The dissent below found this quick turnabout to be unwarranted by the facts and found that the conflict was "for all practical purposes nonexistent, and has been created by the FCC to rationalize a base for its decision." 737 F.2d at 398.

The dissent supported this position by pointing out the illogic of the FCC stand regarding depreciation. For example, the FCC contended that newly prescribed depreciation methods, which give the carriers more revenue in earlier years, better reflect economic reality and thus will increase market efficiency, encourage technological innovation, and otherwise promote competition. The initial problem that the dissent has with this statement is that the FCC never defines the relevant marketplace. Is the

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companies. *Pacific Telephone & Telegraph Co.*, 401 P. 2d 353, 58 PUR 3d 229, 253-254 (Cal. 1965); *Southern Bell Telephone & Telegraph Co.*, 126 PUR 3d 55, 110 (La. PSC 1958); *In Re Adoption of Depreciation Rule for Telephone Companies*, Order 10190 (Florida PSC 1981); *Accounting Treatment for Donations, Dues and Lobbying Expenditures*, 71 PUR 3d 129, 142, (NY PSC 1967); *New York Telephone Co.*, 20 PUR 3d 129, 143 (NY PSC 1956); *Northwestern Bell Telephone Co.*, 43 N.W. 553, 557 (S.D. 1950); *Southwestern Bell Telephone Co.*, 36 PUR 4th 283, 294 (Mo. PSC 1980).

FCC talking about the interstate market for long distance, the intrastate market for long distance, the equipment market, the local service market or some other market? The FCC also never offers any support for the proposition that there is a connection between capital recovery through depreciation rates and the creation of competition in some market place.

Trying to rationalize the FCC's position, the dissent observes that the FCC must want to give the monopolistic local telephone companies more revenue now so that they can be aggressive in future non-regulated aspects of local service and any other businesses in which they can compete. See Judge Greene's decision strongly criticizing the Bell Operating Companies entrance into new businesses because it might interfere with their monopoly local exchange service, *United States v. AT&T, et al.*, C.A. No. 82-0192 slip opinion, entered on July 26, 1984, appeal docketed, No. 83-1865. The dissent observes that "monopoly should depend for its existence on serving all at reasonable rates and should not be permitted to become a financing tool for competitive ventures." 737 F.2d at 398. The dissent then concludes that if the FCC can preempt based on the rationale that telephone companies need more money to promote the competitive aspects of their businesses, the FCC has in effect preempted the entire ratemaking process. After all, the FCC's rationale is so broad that it could apply equally to intrastate depreciation rates, return on equity or any other rate element that makes up a telephone company's revenue requirement.

> If the FCC can achieve preemption of state prescribed depreciation methods by reciting the shibboleth of encouraging competition with as little showing of federal-state conflict as it has made here, it has effectively written 47 U.S.C. Sec. 152 (b) and 221 (b) out of the Communications Act. It seems to me that any ratemaking changes that the carriers want can be adopted, if they persuade the FCC that they need

the money, for any FCC adoption may be imposed on the States by virtue of the Supremacy Clause on the ground that the resultant additional revenue will help the carriers in some theoretical way to compete in some market that need not even be specified, as it was not here. *The logical result of this decision is to permit the FCC to abrogate completely the state regulation of intrastate ratemaking for the carriers' intrastate operations in violation of the Communications Act.* (Emphasis added.)

737 F.2d at 398

B. The FCC Cannot Use General Purpose Language in the Preamble of the Communications Act to Infer a Congressional Objective to Preempt State Regulation of Intrastate Communications When Other Parts of the Communications Act Explicitly Reserve Jurisdiction to the States

To overcome sections 152(b) and 221(b)'s express reservations of state authority over intrastate communications[10] the FCC is reduced to relying on vague "purpose" language in the preamble of the Act which states that the FCC was formed to regulate interstate communications

> to make available . . . to all the people of the United States a rapid, efficient, Nationwide, and worldwide wire . . . communication service . . .

47 U.S.C. Sec. 151.[11]

This Court recently refused to infer a preemptive congressional objective from this type of "purpose language" when other parts of a federal statute explicitly give jurisdiction to the states. *Pacific Gas & Electric Co. v. State Energy Resources Conservation & Development Commission, et al.* 461 U.S. 190 (1983). In that case it was argued that state law frustrated the Atomic Energy Act's purpose, the development of the commercial use of nuclear power. The Court found that, even though Congress' purpose was to develop nuclear power, the promotion of this purpose could not be accomplished "at all costs" when Congress had explicitly preserved state authority over other aspects of the planning, construction, and financing of nuclear power plants. General statements in federal statutes, although reflecting Congress' desire to encourage a certain activity, do not demonstrate a congressional intent to preempt all state actions that may have an adverse impact on that congressional purpose. Such an intent can only be inferred when the congressional intent to preempt is "unmistakably clear". *Pacific Gas & Electric Co. et al. v. State Energy Resources Conservation and Development Commission, supra; Commonwealth Edison Co. v. Montana,* 453 U.S. 609, 633 (1981); *Rice v. Santa Fe Elevator Corp.,* 331 U.S. 218, 230 (1947); *Jones v. Rath Packing Co.,* 430 U.S. 519, 525 (1977); *Florida Lime & Avocado Growers, Inc. v. Paul,* 373 U.S. 132, 142 (1963); *DeCanas v. Bica,* 424 U.S. 351, 356 (1976), citing *Florida Lime & Avocado Growers, supra,* at 142. *Fidelity Federal Savings & Loan Ass'n v. de la Cuesta,* 458 U.S. 141 (1982). *Arkansas Electric Cooperative Corp. v. Arkan-*

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[10]See Appendix B for specific language of 47 U.S.C. § 152(b) and 47 U.S.C. § 221(b).

[11]Also see *Capital Cities Cable Inc. v. Crisp* 467 US . . ., 81 L. Ed.2d 580, 104 S.Ct. 2694 (1984). This case holds that state action which bans out-of-state broadcast signals carried by cable operators is preempted by federal law. This Court upheld preemption because such state action violated 10 years of FCC regulatory activity and because the enforcement of such a ban would compel cable operators "to abandon altogether their carriage of both distant broadcast signals and specialized non-broadcast cable services or run the risk of criminal prosecution". (81 L.Ed at 598) This Court then found such state action to be at odds with the FCC's regulatory goal of making available the benefits of cable communications on a nationwide basis. In the instant case the setting of intrastate depreciation rates has traditionally been a state function and if it continues to be a state function the FCC merely claims that there is a "possibility" that interstate services may be affected in an undefined manner.

sas Public Service Commission, ... U.S. ......, ... L.Ed......., 103 S.Ct. 1905 (1983) When this test is not met "the *legal reality* remains that Congress has left sufficient authority in the states . . ." (emphasis added) 461 U.S. at 223.

In reaching this conclusion the Supreme Court carefully evaluated congressional intent and found that "[g]iven this statutory scheme, it is for Congress to rethink the division of regulatory authority in light of its possible exercise by the states to undercut a federal objective. The courts should not assume the role which our system assigns to Congress." 461 U.S. at 223.

Similarly, in the instant case, although Congress sought in the Communications Act to encourage the development of a "rapid, efficient . . . communications service", 47 U.S.C. 151, this policy does not manifest any congressional intent—much less one that is "unmistakeably clear"—to preempt state regulation of intrastate rates. See 47 U.S.C. 151(b) and 47 U.S.C. 221(b). To decide otherwise would preclude any meaningful state role in the regulation of intrastate communications.

As the legislative history plainly indicates, the Act was designed to preserve state authority over intrastate rates. When Congress was considering comprehensive communication legislation in the early 1930s, state representatives repeatedly urged that the new federal communications agency be denied the ability to adjust intrastate rates when there was an injurious effect on interstate traffic. *Shreveport* Rate Cases: *Houston, East and West Texas Railway Company v. United States,* 234 U.S. 342 (1914). The *Shreveport* holding was later codified in the Transportation Act of 1920, 41 Stat. 484. *Hearings on S.2910 Before the Senate Committee on Interstate*

Commerce, 73rd Congress, 2nd Session 153, 155, 178 (1934), Statements of Messrs. Clardy, McDonald and Benton); and *Hearings on H.R. 8301 before the House Committee on Interstate and Foreign Commerce,* 73rd Congress, 2nd Session 70, 134 (1934), (statements of Messrs. Benton and Clardy).

In the debates preceding the passage of the bill, these concerns were acknowledged by sponsors of the bill. Senator Dill, the Senate manager of the legislation, noted the intended effect of the restriction now codified in 47 U.S.C. § 152(b):

> We have attempted in Title II to reserve to the State commissions the control of intrastate telephone traffic. We have kept in mind the fact that the Interstate Commerce Commission, through the *Shreveport* decision and the decisions in other similar cases, has gone so far in the regulation of railroads that the so-called "state regulation" amounts to very little.

78 Congressional Record 8823 (1934).

Congress thereafter passed the Communications Act, retaining Sections 2(b) and 221(b) of the Act, 47 U.S.C. §§ 152(b) and 221(b), which deny the FCC power to interfere with state regulation of rates and charges incident to intrastate communication service.

C. Congress Has the Sole Authority to Rewrite the Communications Act

By asserting that the "rapid, efficient" language gives the FCC the power to eliminate the authority reserved to the states in the Act, the FCC is challenging Congress' sole authority to create a regulatory scheme in the telecommunications area. The FCC, seeing an alleged administrative need to centralize policy decisions relating to competition

in the telecommunications industry, has chosen to bypass Congress and create a centralized regulatory structure by administrative fiat without statutory authority.[12]

Congress, well aware of the stresses and strains on the Communications Act's regulatory scheme in this new era of competition, has not changed the Act. Instead Congress has left the law alone and preserved the dual regulation of telecommunications.

Indeed "if the Commision believes it needs additional remedial power . . . it should seek such power from Congress. . . . [The courts are] no more authorized than is the Commission to rewrite the law." *Interstate Commerce Commission v. American Trucking Association, Inc.* ...... U.S. ......, ... L.Ed. ......, 104 S.Ct. 2458 (1984); see dissent. In failing to await congressional action, the FCC has acted as though "Congress needs . . . help from generous judicial implications to achieve the supersession of state authority"—despite the ability of "Congress [to] speak with drastic clarity whenever it chooses to assure full federal authority, completely displacing the states." *Bethlehem Steel Company v. New York State Labor Relations Board,* 330 U.S. 767, 780 (1947) (Separate opinion of Frankfurter, J., joined by Murphy and Rutledge, JJ.)

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[12]In contrast, Congress has recently revamped the regulatory scheme for railroads and buses by giving the federal regulatory agency, the Interstate Commerce Commission, the authority to preempt state regulation to carry out the federal policy of promoting competition in those industries. See Staggers Rail Act of 1980 (Pub. L. No. 96-448, 94 Stat. 1895); The Bus Regulatory Reform Act of 1982 (Pub. L. No. 97-261, 96 Stat. 1102) In both instances, Congress gave states the option to carry out federal policy. See 49 U.S.C. 11501, 49 U.S.C. 10935. Unlike Congress, the F.C.C., in the instant case, has given states no other option but to accept the FCC's specific rules and general policies. See *Federal Energy Regulatory Commission v. Mississippi,* 456 U.S. 742 (1982).

II

THE COURT SHOULD REVIEW THIS CASE BECAUSE IT CREATES A CONFLICT BETWEEN A DECISION OF A FEDERAL COURT OF APPEALS AND A STATE COURT OF LAST RESORT

The Supreme Court of Ohio has upheld the decision of the Ohio Public Utilities Commission to set intrastate rates based on its Commission depreciation methodology rather than one approved by the FCC. *Cincinnati Bell Telephone Company v. The Public Utilities Commission of Ohio,* 12 Ohio St. 3rd 280 (1984), appeal docketed, No. 84-623 (S. Ct. Oct. 16, 1984). The court agreed with the rationale of the court in *Southwestern Bell Tel. Co. v. Arkansas Public Service Commission* E.D. Ark March 30, 1984, 584 F.Supp. 1088,[13] when it quoted: " 'Congress expressly limited the FCC jurisdiction, excluding regulation of intrastate communication. 47 U.S.C. Section 220(b).' "

The court went on to quote:

> [I]n the light of the express FCC jurisdictional *limitations* imposed by Congress, the FCC's interpretation of expanding jurisdiction is a non sequitur. The logic of expanding into intrastate jurisdictional matters in the name of 'rapid, efficient, nationwide, world-wide wire and radio communication service with adequate facilities at reasonable charges' [47 USC 151] could, theoretically, allow the FCC to bootstrap itself into preempting *all intrastate* ratemaking determinations. 92 F.C.C. 2d at 876 (citing 47 U.S.C. Section 151). If the FCC wishes to have this authority, it should seek

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[13]This decision was reversed by the Eighth Circuit in *Arkansas Public Service Commission v. Southwestern Bell Tel. Co.,* 738 F. 2d 901 (8th Cir. 1984), petition for cert. filed, No. 84-483 (S.Ct. Sept. 26, 1984).

express congressional approval. The Court finds the FCC preemption of intrastate depreciation methods to be ultra vires and will not enforce it for the plaintiff. (emphasis added)

This finding is in direct conflict with the holding of the Fourth Circuit in the instant case which held that the FCC does have the jurisdictional authority based on 47 U.S.C. § 151 of the Communications Act to preempt state agencies from prescribing depreciation rates for intrastate ratemaking.[14]

CONCLUSION

The decision below obliterates the distinction between what Congress may do and what a federal agency may do. Its affirmance of the FCC's preemptive order has sanctioned the creation of a new jurisdictional framework which lacks the requisite congressional approval and flies in the face of a contrary congressional mandate.

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[14]Other than Ohio, several state commissions have also issued orders which failed to adhere to the FCC's depreciation decision. In nine of these cases the local telephone company brought an action against the state commission in the federal district court, under 47 U.S.C. § 401(b), seeking an injunction mandating compliance with the federal agency's decision. At least one U.S. Court of Appeals has vacated a district court-issued injunction. *New England Tel. & Tel. v. Public Utilities Commission of Maine*, 742 F.2d 1 (1st Cir. 1984).

One case dealing with issuance of a 401(b) injunction mandating compliance with the FCC's decision is presently before this Court in the form of a petition for writ of certiorari. *Arkansas Public Service Commission v. Southwestern Bell Tel. Co., supra.* An amici curiae brief in support of this petition was filed on October 26, 1984 by a group of thirteen state utility commissions, four consumer representatives and two national organizations. This brief discusses all pending actions against state commission in federal courts.

Petitioners therefore respectfully submit that this petition for a writ of certiorari to the United States Court of Appeals for the Fourth Circuit should be granted.

Respectfully submitted,

JANICE E. KERR*
General Counsel
J. CALVIN SIMPSON
Assistant General Counsel
GRETCHEN DUMAS
Principal Counsel
PEOPLE OF THE STATE OF CALIFORNIA AND THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA
350 McAllister Street
San Francisco, CA 94102
**Counsel of Record*
Telephone: (415) 557-0470

DAVID E. BLABEY
General Counsel
LAWRENCE G. MALONE
Counsel
DEPARTMENT OF PUBLIC SERVICE
OF THE STATE OF NEW YORK
Three Empire State Plaza
Albany, New York 12223

FRANK J. KELLEY
Attorney General
LOUIS J. CARUSO
Solicitor General
DON L. KESKEY
LEO H. FRIEDMAN
Assistant Attorney General
THE STATE OF MICHIGAN AND
MICHIGAN PUBLIC SERVICE
COMMISSION
1000 Long Boulevard, Suite 11
Lansing, Michigan 48910
LYNDA S. MOUNTS
CADWALADER, WICKERSHAM & TAFT
1333 New Hampshire Ave., N.W.
Washington, D.C. 20036
Of Counsel

WILLIAM PAUL RODGERS, JR.
General Counsel
CHARLES D. GRAY
Assistant General Counsel
GENEVIEVE MORELLI
Deputy Assistant
General Counsel
NATIONAL ASSOCIATION OF
REGULATORY UTILITY
COMMISSIONERS
1102 ICC Building
Post Office Box 684
Washington, D.C. 20044

JOEL B. SHIFMAN
Attorney
PUBLIC SERVICE COMMISSION
OF WEST VIRGINIA
State Capitol
Charleston,
West Virginia 25305

JACK SHREVE
Public Counsel
OFFICE OF THE PUBLIC COUNSEL
202 Blount Street, Room 624
Tallahassee, Florida 32301

STEVEN W. HAMM
Consumer Advocate for the
State of South Carolina
RAYMOND E. LARK, JR.
Assistant Consumer Advocate
SOUTH CAROLINA DEPARTMENT
OF CONSUMERS AFFAIRS
2801 Devine Street
Columbia,
South Carolina 29250

Susan W. Rester
Special Assistant
Attorney General
Minnesota Department of
Public Service
1102 Bremer Tower
7th & Minnesota
St. Paul, Minnesota 55101

David Lynch
Assistant General Counsel
Iowa State Commerce
Commission
1350 New York Ave., N.W.,
No. 1023
Washington, D.C. 20003

Brian Moline
General Counsel
James Flaherty
Attorney
Kansas State Corporation
Commission
State Office Building
Topeka, Kansas 66612

Howard C. Davenport
General Counsel
Lloyd N. Moore, Jr.
Moore & Hicks
1250 Eye Street, N.W., No. 201
Washington, D.C. 20005
Attorneys for Public Service
Commission of the District
of Columbia

Steven Schur
Chief Counsel
Jon Kingstad
Assistant Chief Counsel
Wisconsin Public Service
Commission
Post Office Box 7854
Madison, Wisconsin 53707

Robert Waldrum
Attorney
Arkansas Public Service
Commission
1000 Center
P.O. Box C-400
Little Rock, Arkansas 72202

Kenneth O. Eikenberry
Attorney General
Larry V. Rogers
Assistant Attorney General
Washington Utilities and
Transportation Commission
Highways-Licenses Building
Olympia, Washington 98504

Irwin I. Kimmelman
Attorney General of
New Jersey
By Alan S. Pralgever
Deputy Attorney General
for the New Jersey Board of
Public Utilities
Division of Law
1100 Raymond Blvd., No. 316
Newark, New Jersey 07102

Joseph I. Lieberman
Attorney General
William B. Gundling
Assistant Attorney General
Peter J. Jenkelunas
Assistant Attorney General
Department of Public Utility
Control/State of
Connecticut
1 Central Park Plaza
New Britain, Connecticut 06051

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In the Supreme Court

OF THE

United States

OCTOBER TERM, 1984

PEOPLE OF THE STATE OF CALIFORNIA AND
PUBLIC UTILITIES COMMISSION OF THE
STATE OF CALIFORNIA, et al.,
Petitioners,

vs.

FEDERAL COMMUNICATIONS COMMISSION AND
UNITED STATES OF AMERICA,
Respondents.

APPENDIX TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

JANICE E. KERR*
General Counsel
J. CALVIN SIMPSON
Assistant General Counsel
GRETCHEN DUMAS
Principal Counsel
PEOPLE OF THE STATE OF
CALIFORNIA AND THE
PUBLIC UTILITIES COMMISSION
OF THE STATE OF CALIFORNIA
350 McAllister Street
San Francisco, CA 94102
*Counsel of Record
Telephone: (415) 557-0470

BOWNE OF SAN FRANCISCO, INC. • 190 NINTH ST. • S.F., CA 94103 • (415) 864-2300

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Appendix A

United States Court of Appeals for the Fourth Circuit

No. 83-1136

[Filed June 18, 1984]

Virginia State Corporation Commission,	Petitioner,
v.	
Federal Communications Commission and United States of America,	Respondent.
North American Telephone Association,	Intervenor./R,
American Telephone and Telegraph Company,	Intervenor./R,
Florida Public Service Commission,	Intervenor./P,
State of Michigan and Michigan Public Service Commission,	Intervenor./P,
Department of Public Utility Control of the State of Connecticut,	Intervenor./P,
People of the State of California and the Public Utilities Commission of the State of California,	Intervenor./P,
National Association of Regulatory Utility Commissioners,	Intervenor./P,
Southern Pacific Communications Company,	Intervenor./R,
Public Service Commission of the District of Columbia,	Intervenor./P,
Public Utilities Commission of Ohio,	Intervenor./P,
Arkansas Public Service Commission,	Intervenor./P,
Kansas State Corporation Commission,	Intervenor./P,
GTE Service Corporation,	Intervenor./R,
Public Service Commission of Wyoming,	Intervenor./P,
Continental Telecom Inc.,	Intervenor./R,
Washington Utilities and Transportation Commission,	Intervenor./P,
United Telephone System, Inc.,	Intervenor./R,
Department of Public Service of the State of Minnesota,	Intervenor./P,
Arizona Corporation Commission,	Intervenor./P,
Cincinnati Bell Inc.,	Intervenor./R,
Citizens of the State of Florida,	Intervenor./P,

National Association of State Utility Consumer Advocates,	Intervenor./P,
Consumer Advocate of South Carolina,	Intervenor./P,
Office of Consumers' Counsel for the State of Ohio,	Intervenor./P,
Iowa State Commerce Commission,	Intervenor./P,
Public Service Commission of Wisconsin,	Intervenor./P,
Public Service Commission of West Virginia,	Intervenor./P,
New York State Department of Public Service,	Intervenor./P,
The Bell Telephone Company of Pennsylvania,	Intervenor./R,
The Chesapeake and Potomac Telephone Company,	Intervenor./R,
The Chesapeake and Potomac Telephone Company of Maryland,	Intervenor./R,
The Chesapeake and Potomac Telephone Company of Virginia,	Intervenor./R,
The Chesapeake and Potomac Telephone Company of West Virginia,	Intervenor./R,
The Diamond State Telephone Company,	Intervenor./R,
Illinois Bell Telephone Company,	Intervenor./R,
Indiana Bell Telephone Company, Incorporated,	Intervenor./R,
Michigan Bell Telephone Company,	Intervenor./R,
The Mountain States Telephone and Telegraph Company,	Intervenor./R,
New England Telephone and Telegraph Company,	Intervenor./R,
New Jersey Bell Telephone Company,	Intervenor./R,
New York Telephone Company,	Intervenor./R,
Northwestern Bell Telephone Company,	Intervenor./R,
The Ohio Bell Telephone Company,	Intervenor./R,
Pacific Northwest Bell Telephone Company,	Intervenor./R,
The Pacific Telephone and Telegraph Company,	Intervenor./R,
Bell Telephone Company of Nevada,	Intervenor./R,
South Central Bell Telephone Company,	Intervenor./R,
Southern Bell Telephone and Telegraph Company,	Intervenor./R,
The Southern New England Telephone Company,	Intervenor./R,
Southwestern Bell Telephone Company,	Intervenor./R,
Wisconsin Telephone Company,	Intervenor./R,
Board of Public Utilities of New Jersey,	Intervenor./R,
Louisiana Public Service Commission,	Intervenor./R.

On Petition for Review from a Decision by the Federal Communications Commission.

Argued October 7, 1983 Decided June 18, 1984

Before Widener, Murnaghan, and Sprouse, Circuit Judges.

Russell W. Cunningham (Donald G. Owens, Sherry H. Bridewell; David E. Blabey, Lawrence G. Malone; Lynwood J. Evans; Richard P. Rosenberry, Lawrence F. Barth; Lloyd N. Moore, Jr.; Donald A. Low, Rosemary O'Leary; Harris S. Leven, Jonathan L. Heller; Jean E. Heilman; Lee McCulloch; Jack Shreve, Benjamin H. Dickens, Jr.; Steven W. Hamm, Raymond E. Lark, Jr., Russell H. Putman, Jr.; Joseph I. Lieberman, Peter J. Jenkelunas; Janice E. Kerr, Gretchen Dumas, J. Calvin Simpson; Douglas N. Owens; Steven R. Shanahan; Bruce W. Renard; Diane L. McIntire; Steven M. Schur, Jon E. Kingstad; Paul Rodgers, Charles D. Gray; Frank J. Kelly, John M. Dempsey; Joel B. Shifman on brief) for Petitioner; John E. Ingle, Deputy Associate General Counsel (Bruce E. Fein, General Counsel, Daniel M. Armstrong, Associate General Counsel on brief) for Respondents; Michael Boudin (Leonard R. Stein; Raymond F. Scully, Lester G. Stiel, W. Preston Granbery; Earl R. Huffman, David Horn; Thomas L. Jones, John Wohlstetter; Richard McKenna, James Hobson; Albert H. Kramer; John W. Hunter, Carolyn C. Hill; Maria A. Kendro on brief) for Intervenors Supporting Respondents.

Murnaghan, Circuit Judge:

The controversy here presented involves an order of the Federal Communications Commission (FCC) entitled "Uniform System of Accounts and Petition for Declaratory Ruling on Question of Federal Preemption." CC Docket No. 79-105, FCC 82-581 (released Jan. 6, 1983). The order provides that, when the FCC has prescribed depreciation rates and methods for classes of property used by telephone companies, state regulation of the same matter is thereby preempted.

Petitioner, Virginia State Corporation Commission, along with multiple Petitioner-Intervenors representing

regulatory agencies of other states, argues that the states' fixing of depreciation rates and accounting methods for intrastate ratemaking purposes is preempted neither by the express language of the Federal Communications Act of 1934, 47 U.S.C. § 151 *et seq.* (1976) (the Act), nor by FCC rules explicitly governing depreciation of telephone equipment and facilities that are used interchangeably to provide both interstate and intrastate service. We agree with the FCC that its order released January 6, 1983 preempts state regulation of the depreciation rates and methods here involved, and thereby reemphasize our recognition in *North Carolina Utilities Commission v. F.C.C.*, 552 F.2d 1036 (4th Cir. 1977) ("NCUC II"), *cert. denied*, 434 U.S. 874 (1977), that "FCC regulations must preempt any contrary state regulations where the efficiency . . . of the national communications network is at stake. . . ." *Id.* at 1046.

I. Background

Under the current state of the telecommunications art, local telephone companies provide "telephone plant" (facilities and equipment) that serve both interstate and intrastate communications needs. Section 152 of the Act provides in subsection (a) that the statute "shall apply to all interstate and foreign communication by wire," but in subsection (b) that "nothing in this chapter shall be construed to apply or to give the Commission jurisdiction with respect to (1) charges, classifications, practices, services, facilities, or regulations for or in connection with intrastate communication service by wire . . . ." Within this framework of divided authority, the Commission's statutory mandate is a broad one, "to make available . . . to all the people of the United States a rapid, efficient, Nationwide, and worldwide wire . . . communication service with adequate facilities at reasonable charges. . . ." 47 U.S.C. § 151.

In order to achieve the mandated goal, the FCC is specifically empowered under 47 U.S.C. § 220 to prescribe depreciation practices to be followed by interstate carriers.[1] At the same time, the Act recognizes the continued vitality of state regulation of intrastate service. Section 221(b) provides that "nothing in this chapter shall be construed to apply, or to give the Commission jurisdiction, with respect to charges, classifications, practices, services, facilities, or regulations for or in connection with wire . . . exchange service . . . even though a portion of such exchange service constitutes interstate . . . communication, in any case where such matters are subject to regulation by a State commission or by local governmental authority." Because most of the nation's telephone plant is used interchangeably to serve both interstate and intrastate telecommunications needs,

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[1]Section 220(b) provides that:

The Commission shall, as soon as practicable, prescribe for such carriers the classes of property for which depreciation charges may be properly included under operating expenses, and the percentages of depreciation which shall be charged with respect to each of such classes of property . . . . The Commission may, when it deems necessary, modify the classes and percentages so prescribed. Such carriers shall not, after the Commission has prescribed the classes of property for which depreciation charges may be included, charge to operating expenses any depreciation charges on classes of property other than those prescribed by the Commission, or after the Commission has prescribed percentages of depreciation, charge with respect to any class of property a percentage of depreciation other than that prescribed therefor by the Commission. . . .

(g) After the Commission has prescribed the forms and manner of keeping of accounts . . . it shall be unlawful for [the carrier] to keep any other accounts . . . than those so prescribed . . . or to keep accounts in any manner other than that prescribed or approved by the Commission. . . .

the potential for conflict between federal and state regulatory action is obvious.[2]

The conflict at issue on this appeal had its genesis in two separate orders issued by the FCC in 1980 and 1981; both orders were designed to compel carriers to employ depreciation practices that more truly reflected actual depreciation rates in light of technological reality. After seven years of study, the FCC first determined in 1980 that the prior practice of "vintage year" grouping for depreciation purposes was inaccurate, and ordered that the "equal life group" method be used. *See* Docket No. 20188, 83 F.C.C.2d 267 (1980). The equal life method permitted greater precision in allocating costs of service to current consumers, and allowed more rapid capital recovery for plant having a short useful life.[3]

Thus, while the prior "vintage year" method was thought to "stifle innovation and inhibit the introduction of new technology," 83 F.C.C.2d at 281, the "equal life" method was intended to bolster the competitive market structure that the FCC sought to foster. The same 1980 order also replaced the "whole life" method of depreciation with the

[2]This Court has already recognized that tandem use of telephone plant to serve both interstate and intrastate needs is quite common. *See North Carolina Utilities Commission v. F.C.C.*, 537 F.2d 787, 794 (4th Cir. 1976) ("NCUC I"), *cert. denied*, 429 U.S. 1027 (1976) (*quoting Katz v. A.T.&T.*, 43 F.C.C. 1328, 1332 (1953)), to the effect that, "[w]ere the Commission to exercise its jurisdiction only where the telephone facilities in question were exclusively interstate in character, it would result in virtually complete abdication from the field of telephone regulation. . . ."

[3]For example, under the "vintage year" method, all types of telephone cable installed during one year (regardless of variations in useful lives of the cables) would be classed together and depreciated over the average useful life of the group. By contrast, the "equal life" method broke plant into smaller subgroups (*e.g.*, indoor cable as opposed to underground cable) that were depreciated separately, more in keeping with the plant's actual useful life.

"remaining life" method, which allowed a carrier to recoup the full cost of plant by making corrections in useful life estimates over time. 83 F.C.C.2d at 288-90.[4]

The FCC's 1981 order provided that inside wiring in homes and businesses no longer should be treated as a capital investment to be depreciated over time, but rather as a cost to be "expensed" to current users. Again, the thrust of the rule change was to ensure that consumers actually requesting and benefitting from installed wiring pay for that benefit. By expensing the wiring, the burden of costs associated with such station connections would be placed on the causative ratepayer, and other consumers would not be forced to bear rates unduly inflated by a depreciation component for wiring services previously provided. 85 F.C.C.2d 818, 824 (1981).

The two orders were first challenged on April 30, 1981, when the National Association of Regulatory Utility Commissioners ("NARUC") filed a Petition for Clarification of the 1981 wiring order. Specifically, NARUC requested that the FCC issue a statement that the provisions of the wiring order were not binding upon state regulatory commissions insofar as intrastate communications service was concerned. The FCC responded to the petition in a Memorandum Opinion and Order of April 27, 1982, in which it concluded that in light of the relevant legislative history of the Act, "where state [accounting and depreciation] regulation is reconcilable with federal policies or rules, there is no occasion for us to override state agency actions in furtherance

[4]Under the "whole life" method, underrecovery had become a common problem, since carriers were locked into inaccurate, overly long estimates of useful life in an industry in which innovation and resulting obsolescence were the order of the day. *See* 83 F.C.C.2d at 289-90.

of legitimate state regulatory objectives."[5] 89 F.C.C.2d 1094, 1108 (1982).

In response to the FCC's opinion and order, the American Telephone and Telegraph Company filed a Petition for Reconsideration on June 7, 1982. General Telephone Company of Ohio likewise petitioned for a Declaratory Ruling that inconsistent state action was foreclosed under the Act.[6] After further pleadings and comments, the FCC reversed its earlier position in a second Memorandum Opinion and Order of January 6, 1983. C.C. Docket No. 79-105, F.C.C. No. 82-581, slip op. (Jan. ...., 1983). After it carefully resurveyed the legislative history and decisional law, and reexamined the express language of the Act, the FCC adopted the view that the most logical and reasonable interpretation of the Act "is that where the Commission prescribes depreciation rates for classes of property [and the

[5]Writing for a 4-3 majority of the Commissioners, Secretary William J. Tricarico found that portions of the Act were geared "to achieve as much uniformity as possible without coercing any state commission to use ratemaking methods it found unacceptable." Tricarico also emphasized that the Commission had always given "special consideration to the needs and views of state commissions in developing accounting and depreciation rules and most State commissions have chosen to follow most accounting and depreciation rules prescribed by this Commission." 89 F.C.C.2d at 1106.

Commissioners Fogarty, Jones, and Rivera issued a Joint Dissenting Statement, in which they recognized the "clear preemptive thrust" of the wiring order and refused to defer to the states on a "critical capital recovery [issue] affecting the continued viability and competitiveness of our Nation's telephone industry in providing increasingly essential interstate, as well as intrastate, facilities and services." *Id.* at 1111.

[6]In its petition, General Telephone noted that the Ohio state regulatory agency had explicitly rejected use of the "remaining life" and "equal life group" methods adopted in the FCC's 1980 order. General Telephone therefore perceived a direct conflict between federal and state regulatory action, which would frustrate importation interests of national communications policy.

depreciation methods to be used], state commissions are precluded from departing" from those rates and methods. *Id.* at 17, ¶ 44. In reversing itself, the FCC espoused the notion that the plain terms of section 220 of the Act appear "clearly to preempt the states in connection with depreciation expense determinations and the related accounting." *Id.* at 6, ¶ 17. Moreover, the FCC found that, even if section 220 did not possess a preemptive effect as a matter of law, the FCC's own policies and rulings would preempt inconsistent state regulatory action as a matter of federal supremacy. *Id.* at 17, ¶ 45.

Supported by numerous state and local regulatory commissions, the Virginia State Corporation Commission ("VSCC") filed a Petition for Review of the January 6, 1983 Order. VSCC alleged that preemption was required neither as a matter of law nor as a result of regulatory action taken by the FCC.

Relying in part on this Court's prior decisions in *NCUC I* and *NCUC II*, and relevant decisions of other Circuits,[7] we hold that inconsistent state regulation of depreciation methods and classes of property to be depreciated has been preempted by the rulings of the FCC. Because we have determined that the affirmative regulatory action taken by the FCC suffices to preempt inconsistent state action, we find it unnecessary to decide whether, as a matter of law, the language of the Act itself requires preemption.

[7]*See Computer and Communications Industry Ass'n v. F.C.C.*, 693 F.2d 198 (D.C. Cir. 1982), *cert. denied*, ... U.S. ..., 103 S.Ct. 2109 (1983); *New York Telephone Co. v. F.C.C.*, 631 F.2d 1059 (2nd Cir. 1980); and *Puerto Rico Telephone Co. v. F.C.C.*, 553 F.2d 694 (1st Cir. 1977), discussed in text *infra*. *Contra Southwestern Bell Telephone Co. v. Arkansas Public Service Comm'n*, No. LR C 84 247, slip op. (Mar. 30, 1984) (Court holds that FCC lacked jurisdiction to issue the January 6, 1983 Order and refuses to enforce it as *ultra vires*).

II. Discussion

While it is true that the Act does reserve to the states the authority to prescribe rates for intrastate telephone service, that reservation is not to be read as preserving the states' sphere of intrastate jurisdiction at the expense of an efficient, viable interstate telecommunications network. Section 152(b) of the Act does make the broad pronouncement that "nothing in [the] chapter shall be construed . . . to give the Commission jurisdiction with respect to . . . intrastate communication service." Section 221(b) further supports state authority by providing that the FCC shall have no jurisdiction "even though a portion of [an] exchange service constitutes interstate or foreign communication, in any case where such matters are subject to regulation by a State commission or by local governmental authority."

Nonetheless, the foregoing provisions are rendered against a statutory backdrop that places *primary emphasis* upon a "rapid, efficient, Nationwide, and world-wide" communication service.[8] Given that overriding concern, the 1983 Opinion by the FCC construing the accounting and wiring orders of 1980 and 1981 is most reasonably interpreted as valid exercise of statutory authority by the FCC, preempting inconsistent state action by virtue of the Supremacy Clause.[9] While VSCC and Petitioner-Intervenors

[8]47 U.S.C. § 151. *But see Southwestern Bell Telephone Co. v. Arkansas Public Service Comm'n*, No. LR C 84 247, slip op. at 3 (Mar. 30, 1984) (holding that FCC lacked jurisdiction to issue the January 6, 1983 Order, the Arkansas District Court refuses to permit FCC's mandate to provide efficient, nationwide service to "allow the FCC to bootstrap itself into preempting" intrastate rate-making determinations).

[9]"This Constitution, and the Laws of the United States which shall be made in Pursuance thereof . . . shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding." U.S. Const. art. VI, cl. 2.

argue that "§ 221(b) has been given an unduly narrow interpretation in recent years,"[10] we do not view as "narrow" an interpretation which recognizes that the Act does not sanction a "state regulation, formally restrictive only of intrastate communication, that in effect encroaches substantially upon the Commission's authority" over interstate telecommunications. *NCUC I*, 537 F.2d at 793.

Such a finding comports well with the recent Supreme Court decision in *Fidelity Federal Savings & Loan Co. v. de la Cuesta*, 458 U.S. 141 (1982). The court stated in *de la Cuesta*, that "[e]ven where Congress has not completely displaced state regulation in a specific area, state law is nullified to the extent that it actually conflicts with federal law. Such a conflict arises when . . . state law 'stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress." *Id.* at 153 (*quoting Hines v. Davidowitz*, 312 U.S. 52, 67 (1941)).[11] Although the

[10]Referring explicitly to this Court's decision in *NCUC I*, counsel for VSCC requested at oral argument that we "revisit" the doctrine adopted in that case, which recognized that the FCC's authority to regulate had "primacy" over state regulatory action purporting to affect the interconnection of customer-provided telephone equipment. *See NCUC I*, 537 F.2d 788 (1976).

[11]Construing the Federal Alien Registration Act of 1940 in *Hines*, the Court recognized that there cannot be any "rigid formula or rule which can be used as a universal pattern" in determining Congress' intention to preempt. 312 U.S. at 67. The factual setting in which each case arises will thus shape the contours of a preemption determination.

See also Pacific Gas and Electric Co. v. State Energy Resources Conservation Development Commission, ... U.S. ...., 103 S. Ct. 1713 (1983), in which the Court again noted that preemption is proper when state law frustrates important federal goals. In *Pacific Gas*, the Court found that agency regulations issued pursuant to the Atomic Energy Act of 1954, 42 U.S.C. § 2011 *et seq.* (1976), did not preempt state authority to curtail the development of nuclear power for economic reasons. Because the Nuclear Regulatory Commission's regulations dealt with plant safety, while the

holding in *de la Cuesta* arose in the context of the Home Owner's Loan Act of 1938, 12 U.S.C. § 1461 *et seq.* (1982), the basic analysis applies to this appeal as well: an appellate court is not to focus narrowly on Congress' own intent specifically to supersede state regulation. Rather, the Court must determine whether the federal agency entrusted with administering the act meant to preempt, and whether such preemptive action is within the scope of the agency's authority. 458 U.S. at 154.[12]

First, it is quite clear that the FCC did intend to preempt inconsistent state regulation governing depreciation methods and classes of depreciable property. The 1983 Memorandum Opinion and Order stated in no uncertain terms that "we find that this Commission's depreciation policies and rates, including the expensing of inside wiring, preempt inconsistent state depreciation policies and rates." C.C. Docket No. 79-105, F.C.C. No. 82-581 (Jan. 6, 1983), slip op. at 17, ¶ 45.

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state regulations dealt with plant economy, compliance with both sets of regulations was possible without thwarting the federal objective. *Id.* at . . . .

[12]The Court explicitly stated in *de la Cuesta,* 458 U.S. at 153-54:

> Federal regulations have no less preemptive effect than federal statutes. Where Congress has directed an administrator to exercise his discretion, his judgments are subject to judicial review only to determine whether he has exceeded his statutory authority or acted arbitrarily. *United States v. Shimer,* 367 U.S. 374, 381-382 (1961). When the administrator promulgates regulations intended to preempt state law, the court's inquiry is similarly limited:
>
> "If [h]is choice represents a reasonable accommodation of conflicting policies that were committed to the agency's care by the statute, we should not disturb it unless it appears from the statute or its legislative history that the accommodation is not one that Congress would have sanctioned." *Id.* at 383.

Second, the regulatory action taken by the FCC was also within its authority to ensure efficient operation of the interstate telephone network. In ordering that certain depreciation methods be followed, the FCC was merely exercising its power under section 220(b) of the Act to prescribe classes of property and percentages to be allowed as depreciation. To be sure, that prescription does have an effect on intrastate rates, but the effect will only be ancillary to the FCC's primary statutory directive to regulate interstate communications. While Petitioner VSCC would seek to prohibit even an ancillary effect on intrastate communications, such a result does not harmonize with the FCC's broader mission. As the FCC observed in *Katz, supra,* it is incumbent upon the FCC to exercise its authority in a manner best calculated to serve the needs of the public, and "[t]he fact that the same instruments are used for both interstate and intrastate services and that intrastate service is subject to state and local regulation does not alter the Commission's duties and obligations with respect to interstate telephone facilities." 43 F.C.C.2d at 1332.

Although the FCC noted in its 1982 Memorandum Opinion and Order that it had "never attempted to prevent any State commission from departing from [federal] accounting and depreciation rules," 89 F.C.C.2d at 1106-07, the fact of the matter is that the FCC never found it necessary to do so until the current decade. During the years of monopoly power, when state commissions tended voluntarily to follow federal directives, there was no realistic need to speak in terms of preemption.[13] In the instant case, how-

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[13]Under section 220(i) of the Act, the FCC is required to give notice to each state commission involved, and to allow a reasonable opportunity for each commission to present its views regarding any requirements prescribed. Moreover, the FCC is required to "receive and consider such views and recommendations." Tripartite

ever, several state commissions refused to follow the FCC's determinations concerning depreciation. Although flexibility in depreciation practice presented little threat to the efficient operation of a monopolistic telecommunications industry, improper capital recovery does pose a true threat in today's competitive market. Thus, the FCC reasonably decided to preempt by issuing orders intended to speed capital recovery and improve accuracy of depreciation calculations, thereby enhancing competition.

VSCC makes much of the argument that the FCC was silent on the issue of depreciation for some forty-seven years,[14] but that prior silence does not vitiate the ongoing authority of the FCC to act once it decides that industry conditions merit preemptive regulation. As the Supreme Court observed in *Smith v. Illinois Bell,* 282 U.S. 133, 159-60 (1930), a state's prerogative to regulate survives *"until*

meetings were commonly held between the FCC, state carriers, and state regulatory agencies, with the FCC often able to accommodate state goals without compromising federal policy. *See* FCC Order of January 28, 1982, 88 F.C.C.2d 1223 (1982) (since late 1940s, FCC prescribed depreciation rates after conferring with carrier representatives and staffs of respective state commissions).

[14]Indeed, the FCC itself observed in its initial Memorandum Opinion and Order of 1982 that it was being asked "to repudiate nearly forty years of administrative practice and applicable state court proceedings by adopting an interpretation of Section 220 that would require an unwilling state commission to follow all accounting and depreciation methods prescribed by this Commission. A very compelling showing would be required to persuade us to follow such a course." 89 F.C.C.2d at 1107.

Nonetheless, since the FCC "is not barred from overruling past precedents when it decides that a previously declared rule is no longer sound or appropriate," *New York Telephone Co. v. F.C.C.*, 631 F.2d 1059, 1065 (2d Cir. 1980), certainly it should not be bound to maintain silence once it determines that articulation of a uniform federal policy is warranted.

action has been taken" by a federal agency vested with jurisdiction over the matter. (Emphasis added).[15] Supporting the FCC's decision to regulate is the consideration that a full seventy-five percent of all investment in new plant falls within the intrastate services category. If that large amount of equipment investment should fail properly to reflect its true, rapid depreciation, interstate service would then suffer the effects of delayed innovation.

As noted above, decisions of other Circuits have recognized the necessity for federal preemption of inconsistent state telecommunications policy. In *Computer and Communications Industry Ass'n v. F.C.C.*, 693 F.2d 198 (D.C. Cir. 1982), *cert. denied,* ...... U.S. ......, 103 S. Ct. 2109 (1983), it was found that state tariffing of customer premises equipment ("CPE") "must necessarily yield to the federal regulatory scheme." *Id.* at 214. The federal scheme required that charges for CPE (*e.g.,* home computer terminals, data processing units) be separated from ordinary transmission service charges. Since CPE is used interchangeably for both interstate and intrastate service, such a decision would have a clear ancillary effect on intrastate rates.

[15]In *Smith,* the Court found that, in the absence of federal regulatory action "which could be deemed validly to affect the amount to be charged in connection with intrastate business so as to affect intrastate rates," the jurisdiction of the state is "not to be gainsaid" in determining depreciation amounts for intrastate telephone business. 282 U.S. at 159-60.

See also Northwestern Bell Telephone Co. v. Nebraska State Railway Commission, 297 U.S. 471 (1936), in which the Court found that pending action by the FCC to establish depreciation rates, state control over such rates remained unimpaired. The Act "contemplated no restriction of state control over depreciation rates until the [FCC] had prescribed its own rates." *Id.* at 478.

Whereas the decisions in *Smith* and *Northwestern Bell* were predicated upon the FCC's inaction, the instant appeal presents a clear case of affirmative, preemptive action properly taken by the agency.

Nonetheless, the Court refused to perceive any distinction between the preemption principles to be applied in the case of state ratemaking issues, and those applicable to other state powers. *Id.* at 216. Thus, ancillary effect on intrastate rates was permitted in order to achieve the federal goals of unfettered CPE selection, market competition, and a greater number of equipment and payment options.

The Court in *Computer and Communications Industry* relied in large part on this Circuit's decisions in *NCUC I* and *NCUC II* to support preemption. In *NCUC I*, we held that state regulation that "encroaches substantially" upon federal authority was preempted. 537 F.2d at 793. The conflict in that case dealt directly with policies concerning physical interconnection of non-carrier provided CPE to transmission facilities used jointly for interstate and intrastate needs. Preemption was required, even though we recognized that the FCC had no authority "over local services, facilities and disputes that in their nature and effect are separable from and do not substantially affect the conduct or development of interstate communications." *Id.*

While it may be true that the effects of depreciation policies are more attenuated than the very direct effect produced by physical connection of equipment to interchangeable lines, it cannot be said that depreciation policies are "separable from" interstate communications. Indeed, the conduct and development of interstate communications would undoubtedly be affected by the states' imposition of depreciation policies that slowed capital recovery and innovation. *See also NCUC II*, in which we recognized the preemptive effect, or "federal primacy," of the Commission's registration program for terminal equipment subject to interchangeable use: "If it is admitted—as we think it must be—that the FCC has full statutory authority to regulate joint terminal equipment

to ensure the safety of the national network, then we can discover no statutory basis for the argument that FCC regulations serving other important interests of national communications policy are subject to approval by state utility commissions." 552 F.2d at 1046-47.

The finding of federal primacy was echoed by the Court of Appeals for the Second Circuit in *New York Telephone Co. v. F.C.C.*, 631 F.2d 1059 (2d Cir. 1980), a case which involved an assertion of federal jurisdiction over local exchange service when used in connection with interstate foreign exchange services. Citing *Northwestern Bell* for the proposition that state regulation continued unabated only when the federal agency "had not regulated in [the] area," 631 F.2d at 1066, the Court held that once the FCC acted to impose its own tariff regulations, inconsistent state regulation was necessarily preempted.

Finally, the Court of Appeals for the First Circuit explicitly adopted the rationale of *NCUC I* in *Puerto Rico Telephone Co. v. F.C.C.*, 553 F.2d 694 (1st Cir. 1977). The Court first acknowledged that federal primacy would have the "anomalous" result of ousting Puerto Rico's jurisdiction over equipment used primarily for intrastate calls. However, the Court found it "even more anomalous, in light of FCC's broad [statutory] mandate . . . that § 152(b) ousts federal jurisdiction over all facilities that are also used for intrastate telephone service." *Id.* at 700.[16]

It is true that *Puerto Rico Telephone*, like *NCUC I*, involved a federal policy relating to physical interconnection of CPE that was nonseverable from the interstate communications system. By contrast, the instant appeal raises no question of actual physical impossibility of complying

[16]Section 152(b) provides, "[N]othing in this chapter shall . . . give the Commission jurisdiction with respect to . . . charges, classifications, practices, services, facilities, or regulations for or in connection with intrastate communication service. . . ."

with dual federal and state regulation; presumably, the carriers could keep accounts in which assets would be separately depreciated for intrastate and interstate purposes.[17] Nonetheless, physical impossibility is but one ground for preemption; frustration of federal objectives provides a rationale at least equally valid. Since inconsistent state regulation poses an impediment to rapid development of interstate facilities, preemption is justified in this case even if "physical impossibility" is not at issue.

In deciding the case, we have been mindful of an observation made by Chief Justice Burger when a member of the Court of Appeals for the District of Columbia in *General Telephone Company of California v. F.C.C.*, 413 F.2d 390 (D.Cir. 1969), *cert. denied,* 396 U.S. 888 (1969). Applying the Act in the context of cable television broadcasting, Chief Justice Burger stated that "[t]he Act must be construed in light of the needs for comprehensive regulation and the practical difficulties inhering in state by state regulation of parts of an organic whole." *Id.* at 398. To be sure, practical difficulties have come to abound in this age of technological innovation since Chief Justice Burger rendered his opinion almost fifteen years ago. In response to some of the difficulties, the FCC's decision to preempt inconsistent state depreciation practices emerges as a reasonable one, designed to foster the statutory goal of an efficient nationwide telecommunications service. Our review satisfies us that the FCC's Memorandum Opinion and Order of January 6, 1983 should be AFFIRMED.

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[17] *But see People of the State of California v. F.C.C.*, 567 F.2d 84, 86 (D.C. Cir. 1977), *cert. denied*, 434 U.S. 1010 (1978). In that case, the Court observed that requiring the maintenance of "'two redundant facilities or [investment] in expensive additional equipment' would frustrate the Commission's responsibility 'to make available, so far as possible . . . a rapid, efficient, Nationwide and world-wide wire . . . communications service with adequate facilities at reasonable charges,'" (*quoting* 47 U.S.C. § 151). Likewise, the expense associated with dual accounting could needlessly inflate the cost of services provided to consumers.

Widener, Circuit Judge, dissenting:

I respectfully dissent.

I am unable to agree that the FCC orders prescribing depreciation practices for common carriers' interstate operations require or warrant preemption of state regulation prescribing different depreciation methods for carriers' intrastate operations. Such preemption conflicts with the FCC's jurisdictional limitations and with this court's reading of the Supremacy Clause in *North Carolina Utilities Commission v. FCC* (*NCUC I*), 537 F.2d 787 (4th Cir.), *cert. denied,* 429 U.S. 1027 (1976), and *North Carolina Utilities Commission v. FCC* (*NCUC II*), 552 F.2d 1036, *cert. denied,* 434 U.S. 874 (1977). The FCC properly recognized these limitations in its order of April 27, 1982, in which it specifically found that its prescription of new accounting procedures "does not preclude state commissions from using other accounting or depreciation procedures for intrastate ratemaking proceedings." *In re* Amendment of Part 31, 89 F.C.C.2d 1094, 1095 (1982), *rev'd,* CC Docket No. 79-105 (F.C.C. Jan. 6, 1983). Its order of January 6, 1983, finding that the States were preempted after all, not only violates statutory strictures on the FCC but also legal limitations on any agency making such a dramatic change in policy.

The Communications Act explicitly deprives the FCC of jurisdiction to regulate directly "charges, classifications, practices" and "facilities," among other things, for or in connection with intrastate communication service. 47 U.S.C. §§ 152(b), 221(b). Unlike other areas of the law in which the term "intrastate" has come to include virtually nothing, communication carrier accounting has until now retained a clear division between its intrastate and interstate components, and this because of the Communications Act itself. Equipment and facilities used for intrastate communications are segregated on the carriers' books from those used

for interstate communications, and the States and the FCC have regulated accounting for such equipment and facilities concurrently within their respective intrastate and interstate spheres. About 75% of depreciable assets are considered intrastate. The section of the Communications Act giving the FCC authority to prescribe depreciation practices for carriers, 47 U.S.C. § 220(b), therefore cannot be read to "require preemption" of state-imposed depreciation practices for the intrastate portion of carriers' operations. More directly put, the FCC does not have jurisdiction to prescribe directly the depreciation practices to be followed as to equipment and facilities allocated to intrastate communications.[1]

The proper analysis of this case, then, is whether the state regulation of depreciation practices as to carriers' intrastate operations conflicts with the FCC regulation of such practices for carriers' interstate operations to a degree that it requires preemption of the state regulation under the Supremacy Clause of the Constitution. This court set forth the rule in *NCUC II* that FCC regulation of facilities and equipment must preempt contrary state regulation where the efficiency or safety of the national communications network or "other important interests of national communications policy" are at stake. *NCUC II,* 552 F.2d at 1046-47. *NCUC I* and *NCUC II* involved FCC deregulation of equipment such as subscribers' telephones used jointly in interstate and intrastate communication. When the FCC rescinded its interstate tariff preventing subscribers from providing their own telephones on the ground that the tariff violated the FCC's statutory mandate to prevent unreasonable and unjustifiably discriminatory rates, *see NCUC II,* 552 F.2d at 1042; *NCUC I,* 537 F.2d at 792, some States rejoined that they could prescribe rules forbidding consumers to connect their own telephones unless the telephones were used exclusively in interstate communication. *See NCUC II,* 552 F.2d at 1043; *NCUC I,* 537 F.2d at 790. This court found that the FCC action preempted the inconsistent state regulation, since the same telephones were used in interstate and intrastate communication and since state regulation prohibiting such connection would negate the federal tariff permitting such connection. *NCUC II,* 552 F.2d at 1043. "Something had to give." *Id.*

[1]As this court noted in *NCUC I,* "[T]he provisions of section 2(b) [47 U.S.C. § 152(b)] deprive the Commission of regulatory power over local services, facilities and disputes that in their nature and effect are separate from and do not substantially affect the conduct or development of interstate communications." *NCUC I,* 537 F.2d at 793.

This sort of conflict simply is not present here. As this court noted in *NCUC I,* "[R]ate making typifies those activities of the telephone industry which lend themselves to practical separation of the local from the interstate in such a way that local regulation of one does not interfere with national regulation of the other." *NCUC I,* 537 F.2d at 793 n. 6.

The supposed conflict here is at least more attenuated, as the majority admits; in my view it is for all practical purposes nonexistent, and has been created by the FCC to rationalize a base for its decision. The Commission claims that if the States do not follow the FCC's depreciation methods they will frustrate the FCC's policy of "encouraging competition" where market conditions will support such a policy. The FCC's claim in essence is that its newly prescribed depreciation methods, which give the carriers more revenue in earlier years, more closely reflect economic reality and thus will increase market efficiency, encourage technological innovation, and otherwise promote competition. Even if this theorizing is correct as to the effect that the FCC's prescribed depreciation procedures for the carriers' interstate operations will have on the highly competitive interstate communications market, I cannot see how nonconforming depreciation methods for the carriers'

intrastate operations can frustrate competition in the interstate communications markets within which there is competition. The only rationale I can find for the FCC's position is that the States, if not required to follow the FCC's lead, will allow the carriers less revenue from the carriers' noncompetitive intrastate operations which the carriers could use to be aggressive in the small area in which they compete with the competitive interstate carriers.[2] Besides being undesirable from the standpoint of the Communications Act, this fact strikes me as encouraging to the point of requiring the use of intrastate monopoly power to finance competition with the competitive interstate market, a practice as dangerous as it is unauthorized, for monopoly should depend for its existence on serving all at reasonable rates and should not be permitted to become a financing tool for competitive ventures.

Moreover, and more fundamentally, if the FCC can achieve preemption of state-prescribed depreciation methods by reciting the shibboleth of encouraging competition with as little showing of federal-state conflict as it has made here, it has effectively written 47 U.S.C. §§ 152(b) and 221(b) out of the Communications Act. It seems to me that any ratemaking changes that the carriers want can be adopted, if they can persuade the FCC that they need the money, for any FCC adoption may be imposed on the States by virtue of the Supremacy Clause on the ground that the resultant additional revenue will help the carriers in some theoretical way to compete in some market that need not even be specified, as it was not here. The logical result of this decision is to permit the FCC to abrogate completely the state regulation of intrastate ratemaking for the carriers' intrastate operations in violation of the Communications Act.

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[2] I have not even considered that most of the carriers are only marginally engaged in long distance (interstate) communication, that field being dominated by AT&T and its new found competitors.

Ironically, the FCC recognized established law and practice in holding, before it reversed itself only a little more than eight months later, that

> "[w]here state regulation is reconcilable with federal policies or rules, there is no occasion for us to override state agency actions in furtherance of legitimate state regulatory objectives. Section 2(b) [47 U.S.C. § 152(b)] makes clear that Congress did not intend this Commission to foreclose state ratemaking actions unless those actions imperiled 'important interests of national communications policy. . . .' *NCUC II,* 552 F.2d at 1047. We have found in this instance that federal regulation will not be frustrated if carriers maintain additional records for intrastate ratemaking purposes." *In re Amendment of Part 31,* 89 F.C.C.2d 1094, 1108 (1982), *rev'd,* CC Docket No. 79-105 (F.C.C. Jan. 6, 1983)."

The Supreme Court requires that "an agency changing its course . . . supply a reasoned analysis," *Motor Vehicle Manufacturers Association v. State Farm Mutual Automobile Insurance Co.,* 51 U.S.L.W. 4953, 4960 (1983), which must include a "rational connection between the facts found and the choice made." 51 U.S.L.W. at 4956, *citing Burlington Truck Lines v. United States,* 371 U.S. 156, 168 (1962). The FCC's post-hoc reinterpretation of legislative history, on which the majority here quite properly does not depend, combined with the unsupported and unsupportable statements as to the effect on competition of inconsistent state depreciation methods, do not provide even a modicum of reasoned analysis supporting the FCC's decision to interfere in state ratemaking after several decades of affirmatively espousing the opposite conclusion.

The upshot of the case is that the FCC decided that the carriers needed more revenue than the state regulatory

agencies were willing to provide, so it decided to impose different depreciation rates on intrastate equipment for the very purpose of, and thus effectively, raising the intrastate rates of the subscribers[3] just as surely as if it had done so directly. I can find neither justification nor authority in the Communications Act for this action. The final irony is the FCC justification of its action on the ground that it will ". . . bring the benefits of competition to the ratepayers of this country." The "benefits of competition" are higher telephone bills for local ratepayers, and I feel confident that, like the man being ridden out of town on a rail, were it not for the honor of the thing, they had rather walk.

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[3]Remarkable as it may seem, these facts are either expressly or implicitly acknowledged in para. 37 of the FCC order as well as other parts.

I note in passing that, as late as *NCUC I* (1976) 97% of the telephone calls in the country were local. The proportion could not be too different today.

United States Court of Appeals
for the Fourth Circuit

No. 83-1136

Virginia State Corporation Commission,
Petitioner,

versus

Federal Communications Commission
and United States of America,
Respondent.

[Filed Oct. 3, 1984]

ORDER

The petitions for rehearing and suggestions for rehearing in banc have been submitted to the Court. Upon the request for a poll of the Court on the suggestions for rehearing in banc, Judge Russell, Judge Phillips, Judge Murnaghan, and Judge Sprouse voted to deny the petitions for rehearing in banc; Judge Widener voted in favor of rehearing in banc; Chief Judge Winter, Judge Hall, Judge Ervin and Judge Chapman are disqualified. Judge Wilkinson abstains from voting.

IT IS ADJUDGED and ORDERED that the petitions for rehearing and suggestions for rehearing in banc are DENIED.

Entered at the direction of Judge Murnaghan, with the concurrence of Judge Sprouse. Judge Widener dissents.

For the Court,

JOHN M. GREACEN
Clerk

Before the
Federal Communications Commission
Washington, D.C. 20554

FCC 82-155
31078
CC Docket 79-105

In the Matter of

Amendment of Part 31,
Uniform System of Accounts
for Class A and Class B
Telephone Companies, of the
Commission's Rules and Regulations
with respect to accounting for
station connections, optional
payment plan revenues and
related capital costs, customer
provided equipment and sale of
terminal equipment.

Memorandum Opinion and Order

Adopted: April 1, 1982 Released: April 27, 1982

By the Commission: Commissioners Fogarty and Jones dissenting and issuing a joint statement.

1. We have before us a petition for clarification of our *First Report and Order* in this proceeding (85 FCC 2d 818 1981)) filed by the National Association of Regulatory Utility Commissioners (NARUC) and a petition for reconsideration of that *Report and Order* filed by the People of the State of California and the Public Utilities Commission of the State of California (California). The *First Report and Order,* commonly known as "Expensing of Station Connections," adopted a number of changes in Part 31 of this Commission's Rules (Uniform System of Accounts for Class A and Class B Telephone Companies). The principal changes

required that future costs of installing new inside wiring and similar costs be included as an expense in Account 605 (Repair of Station Equipment). Such costs have previously been capitalized in Account 232 (Station Connections). The *First Report and Order* also required that the present net investment in inside wiring and investment that will be added during a transition period be amortized over a period of 10 years. That requirement superseded existing depreciation prescriptions for such investment.

2. Both petitions raise the question of whether, and to what extent the adoption of the *First Report and Order* limits the discretion of state commissions to follow different accounting and depreciation procedures for purposes of computing revenue requirements for intrastate telecommunications services. NARUC seeks a clarification of the *First Report and Order* declaring that it does not restrict the discretion of the state commissions and California seeks reconsideration of our decision to the extent that it purports to restrict the discretion of state commissions. GTE Service Corporation (GTE) and American Telephone and Telegraph Company (AT&T) have filed oppositions to the petitions. Those companies contend that the *First Report and Order* does and should restrict the discretion of the state commissions.

3. We have concluded that the *First Report and Order* does not preclude state commissions from using other accounting or depreciation procedures for intrastate ratemaking proceedings. Thus we are granting the NARUC petition insofar as it seeks such a clarification. In view of our conclusion that state commissions are not precluded from using their own accounting and depreciation procedures for intrastate ratemaking purpose it is unnecessary to consider further the California petition and it will be dismissed as moot.

I. Nature of the *First Report and Order*

4. In our Phase II *Final Decision and Order* in Docket 19129, 64 FCC 2d 1, 54-56 (1977), we concluded that it would be desirable to place costs associated with station connections on the causative ratepayer. We accordingly ordered AT&T to submit a plan for changing the accounting treatment of station connection costs that would be consistent with that objective. *Id.* at 110. AT&T responded by filing a petition for rulemaking (RM-3017) that proposed amendments to Part 31 of our Rules. After reviewing that petition, we instituted this proceeding by inviting comments upon a somewhat different proposal to modify accounting for station connections.[1]

5. After reviewing the comments, we concluded that any changes in the accounting or other regulatory treatment of station connections should not include drop or block lines and protectors. We also concluded that changes in accounting procedures would not be sufficient in and of themselves to place other station connection costs on the causative ratepayer. This is the case because costs associated with the provision of inside wiring necessarily must be apportioned between the federal and state jurisdictions as long as inside wiring is provided as a tariffed service subject to dual regulation. Complete unbundling cannot be achieved by expensing rather than capitalizing such costs because both the telephone operations investment and telephone operations expenses are apportioned for purposes of computing an interstate and an intrastate telecommunication service revenue requirement. Complete unbundling could be achieved by determining that the provision of inside wiring should be provided on a detariffed basis. We have, of

[1]Notice of Proposed Rulemaking (CC Docket 79-105), 44 F.R. 48988 (August 14, 1979). We also invited comment upon some other proposed accounting changes that are closely related to station connections.

course, made such a determination with respect to customer premises equipment and have adopted rules to separate that business from the telephone operations that are subject to tariff regulation.[2] We concluded that it would be premature to adopt such a fundamental change in the regulatory status of inside wiring without conducting further inquiry.

6. Nevertheless, we concluded that changes in accounting and depreciation procedures that would facilitate implementation of any decision to change the regulatory status of inside wiring would be desirable in the absence of such a change. We accordingly issued a *First Report and Order* adopting changes in accounting and depreciation rules and a separate *Further Notice of Inquiry* (86 FCC 2d 885(1981)) inviting additional comments with respect to possible changes in the regulatory status of inside wiring. The *First Report and Order* does not produce any change in regulatory status. The interstate portion of the embedded net investment will be reflected in the return component of the interstate telecommunication service revenue requirement and the interstate portion of the annual amortization and the new installation expenses will be reflected in the expense component of that revenue requirement. Unless and until we determine that inside wiring should not be provided as part of a tariffed service, the new accounting rules will not have a greater or different effect than any other accounting rules we have prescribed for the purpose of computing the interstate telecommunication service revenue requirement.

7. Insofar as the petitions seek a determination with respect to this Commission's purpose and intent, we con-

[2]See *Primary Instrument Concept (PIC)*, 68 FCC 2d 1157 (1978); *Second Computer Inquiry Final Decision*, 77 FCC 2d 384 (1980), *recon.*, 84 FCC 2d 50 (1980); *further recon.*, (FCC 81-481, released October 30, 1981).

clude that the *First Report and Order* was not intended to have any preemptive effect that does not arise by operation of law. The discussion of the effects of expensing upon intrastate rates and revenue requirements in that Order was based upon the assumption that all or most state commissions would choose to follow those rules for purposes of computing intrastate telecommunication service rates. Our decision to permit carriers to accelerate the transition to expensing with the approval of state regulatory commissions was also based on the assumption that few, if any, of the state commissions would choose to prohibit expensing for intrastate ratemaking purposes. Such assumptions appeared reasonable because most state commissions have followed most accounting and depreciation procedures prescribed by this Commission in the past and the considerations that led us to conclude that expensing will benefit both carriers and consumers in the long run are equally applicable to intrastate ratemaking. No policy of this Commission would be furthered by requiring state commissions to adhere to the rules we have adopted for purposes of computing the interstate revenue requirement. If carriers adhere to our rules for purposes of computing the interstate revenue requirement, our purpose will be achieved.

8. The participants in this proceeding may not view the preemption issue as a question of intent, but rather as a matter of statutory interpretation. The petitioners may be contending that this Commission could not require state commissions to follow our accounting or depreciation rules for intrastate ratemaking purposes and AT&T and GTE apparently contend that Section 220 of the Communications Act precludes state commissions from departing from any accounting or depreciation rule that has been prescribed by this Commission. To the extent this is the case, this controversy might more appropriately be characterized as a request for a declaratory ruling with respect

to the meaning and effect of Section 220 that is not limited to these particular rules. We do not propose to deny relief because the petitions or oppositions may not be properly labeled. We have concluded, for reasons explained in Part II, that Section 220 does not preclude state commissions from departing from accounting or depreciation rules prescribed by this Commission for purposes of regulating intrastate telecommunication service rates.

II. Effect of Section 220

9. AT&T and GTE rely primarily upon Subsection 220(g) to support their contention that Section 220 precludes the states from departing from our accounting and depreciation rules for purposes of computing intrastate telecommunication service revenue requirements. Subsection (g) provides:

> (g) After the Commission has prescribed the forms and manner of keeping of accounts, records, and memoranda to be kept by any person as herein provided, it *shall be unlawful for such person to keep any other accounts, records, or memoranda than those so prescribed* or such as may be approved by the Commission or to keep the accounts in any other manner than that prescribed or approved by the Commission. Notice of the alterations by the Commission in the required manner or form of keeping accounts shall be given to such persons by the Commission at least six months before the same are to take effect. (Emphasis added)

10. Subsection (g) does not literally impose any restriction upon the power of the states to regulate intrastate rates or the methods state commissions use to determine whether a particular rate will be approved or prescribed. A state commission could theoretically adjust information derived from a carrier's system of accounts for purposes of its own ratemaking without creating any conflict with obligations that Subsection (g) imposes upon carriers.

Nevertheless, it would be extremely difficult as a practical matter for a state commission to perform such ratemaking computations without requiring a carrier to collect and compile some data in some form that might be described as "accounts, records or memoranda." Thus, AT&T and GTE may be contending that Subsection (g) implicitly precludes the use of other accounting methods or systems for other regulatory purposes when this Commission has prescribed methods that must be used for interstate ratemaking purposes.

11. Subsection (a)-(g) of Section 220 were in the main a reprint of provisions contained in Section 20 of the Interstate Commerce Act.[3] Although the Interstate Commerce Act was designed for the regulation of railroads, many of the provisions were extended to communications common carriers and the Interstate Commerce Commission was in the process of developing accounting and depreciation rules for telephone companies at the time the Communications Act was adopted. In the absence of statutory changes or indications to the contrary, it is assumed that whenever the legislature enacts or reenacts a provision in an existing statute it has in mind the previous statute relating to the same subject matter.[4] Unless the context indicates otherwise, words and phrases in a provision that were used in a prior act pertaining to the same subject matter will be construed to be used in the same sense.[5]

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[3]At the time of adoption of Section 220(g) of the 1934 Communications Act, Section 20(5) of the Interstate Commerce Act provided that ". . . it shall be unlawful for such carriers to keep any other accounts, records, or memoranda than those prescribed by the Commission . . ." 41 Stat. 493 (1920). See 49 U.S.C. § 20(5).

[4]Courts have attached great weight to interpretations of Interstate Commerce Act provisions in interpreting the Communications Act. See e.g., *American Telephone and Telegraph Company v. F.C.C.*, 487 F.2d 864, 873-874 (2d Cir. 1973).

[5]See Sutherland, *Statutory Construction*, Section 51.02 (C. Sands ed. 1972) and cases cited therein.

12. The parallel Section 20 language was added to the Interstate Commerce Act by the Hepburn Act of 1906, 34 Stat. 584. The legislative history of the Hepburn Act does not shed any light upon Congressional reasons for prohibiting railroads from maintaining accounts, records on memoranda other than those prescribed by the ICC. Congress may have wished to inhibit the railroads from defrauding investors through fraudulent or sloppy accounting practices or to prevent the railroads from concealing unlawful rebates. There is no indication in the legislative history of the Hepburn Act that the 1906 Congress wished to curb state regulation of railroads. That Act was apparently motivated solely by a desire to make railroad regulation more effective.

13. ICC accounting rules that were promulgated pursuant to Section 20 of the Interstate Commerce Act were challenged in *Int. Com. Commission v. Goodrich Trans. Co.*, 224 U.S. 194 (1912) (hereinafter cited as *Goodrich*). The railroad contended that the ICC had exceeded its authority by prescribing the form of accounts for activities that were not subject to ICC rate regulation. The Supreme Court sustained the ICC accounting rules on the theory that the ICC needed information about such activities in order to regulate the activities that were subject to ICC rate regulation. The Court said (*id.* at 211):

> If the Commission is to successfully perform its duties in respect to reasonable rates, undue discriminations and favoritism, it must be informed as to the business of the carriers by a system of accounting which will not permit the possible concealment of forbidden practices in accounts which it is not permitted to see and concerning which it can require no information. It is a mistake to suppose that the requiring of information concerning the business methods of such corporations, as shown in their accounts, is a regulation of business not within the jurisdiction of the Com-

mission, as seems to be argued for the complainants. The object of requiring such accounts to be kept in a uniform way and to be open to the inspection of the Commission is not to enable it to regulate the affairs of the corporations not within its jurisdiction, but to be informed concerning the business methods of the corporations subject to the act that it may properly regulate such matters as are really within its jurisdiction.

14. *Goodrich* is of limited relevance because that case did not raise any question with respect to the effect of ICC accounting rules upon the regulation of activities that were not subject to ICC rate regulation. Nevertheless, a construction of Section 20 that would have limited the states' discretion to regulate intrastate rail rates would have been inconsistent with the Court's description of the nature and function of the accounting rules.

15. The adoption of an interpretation of Section 20(5) of the Interstate Commerce Act or Section 220(g) of the Commerce Act that restricts state accounting practices for purposes of intrastate ratemaking would also restrict other forms of state or federal regulation that might require accounting records or information that differ from data generated by the rules prescribed for interstate ratemaking. Indeed such an interpretation would appear to preclude carriers from using accelerated depreciation methods for purposes of computing their income taxes since such methods differ from the depreciation methods that have been prescribed for ratemaking purposes.

16. The question of the effect of ICC accounting requirements upon railroad tax accounting did arise before the Communications Act was enacted. The Interstate Commerce Commission had required a railroad to amortize the value of certain abandoned property over a period of 15 years and to charge the amortized amounts as an operating expense for accounting purposes. The railroad contended in *Kansas City Southern Ry. Co. v. Commissioner of Int. Rev.*, 52 F.2d 372 (8th Cir. 1931) that the Commissioner was required to accept the amortized expenses as a deduction from income because failure to do so would violate Section 20 of the Interstate Commerce Act. The Court summarily rejected that contention.

The Court said (*Id.* at 378):

> The Commission did not purport in requiring the loss for abandonment to be charged to operating expenses to provide any standards for tax authorities to follow. This would be beyond its province. . . . Systems of accounting for railroads under the control of the Commission cannot interfere with the government's system of taxation. The Commission has no power to direct how the Revenue Laws of the United States shall be interpreted or by its orders provide standards to govern the tax authorities.

17. AT&T apparently contends that providing standards for state regulators to follow was within the Interstate Commerce Commission's province and that the ICC had specifically rejected contentions that Section 20 of the Interstate Commerce Act did not give it that power. AT&T's reliance on *Depreciation Charges of Telephone Companies*, 118 I.C.C. 295 (1926), is misplaced. In the *Depreciation Charge* proceeding, NARUC had argued that the words "as soon as practicable" contained in section 20(5) gave the ICC latitude to refrain from prescribing depreciation requirements for the local telephone companies engaged only to an insignificant extent in interstate commerce. In rejecting NARUC's position, the ICC merely held that its obligation under Section 20(5) to prescribe depreciation rates for telephone companies was mandatory, not discretionary.[6] In dicta, the Commission additionally appeared to

[6] 118 I.C.C. at 332-33.

suggest that its authority under Section 20(5) extended to all property "open for use in interstate commerce." Petitioners in CC Docket No. 79-105, however, do not appear to dispute the authority of the FCC, under section 220 of the Communications Act, to extend its accounting and depreciation prescriptions to cover assets used for primarily intrastate purposes. The ICC's 1926 telephone depreciation charge proceeding is silent on the issue of whether federal prescription of depreciation rates preempts the states from prescribing additional and distinct depreciation rates and classifications covering the same property for regulatory purposes.[7]

18. AT&T further cites *Accounting Rules For Telephone Companies,* 203 ICC 13 (1934), in support of its contention that state commissions lack jurisdiction over telephone company accounts insofar as intrastate service is concerned. Here, again, we disagree with AT&T's reading of this opinion. In *Accounting Rules For Telephone Companies* (an advisory opinion for the benefit of the newly created Federal Communications Commission) the ICC concluded, over the objections of the states, only that the federally-prescribed system of accounts should be uniform in its treatment of telephone companies operating among the several states.[8] Indeed, far from preempting the states from independently prescribing separate additional accounts, the ICC expressly recognized that the states might have additional accounting needs and sought to assist the states in this respect by permitting state-prescribed subaccounts within the federally-required books of account. The ICC stated:

[7]Indeed, the Supreme Court has placed this same construction on the ICC's order in the *Depreciation Charge* proceeding. *Smith v. Illinois Bell Tel. Co.*, 282 U.S. 133, 159 (1930).

[8]See also, *Kansas City So. Ry. v. United States,* 231 U.S. 423 (1931); and *Int. Com. Comm. v. Goodrich Trans. Co., supra.*

> In the measures adopted with respect to the uniform system, we are acting in pursuance of the direction of Congress. Uniformity is the desired and important object. The nature of the undertaking necessarily precludes the incorporation of special provisions covering the requirements of the several State commissions.
>
> We have, however, recognized the needs of the several State commissions in the intrastate regulation which is their duty and have, endeavored to help them in the securing of all necessary information by leaving it open to them to require subdivision of the accounts prescribed.

Since the ICC may not delegate any of its authority under the Interstate Commerce Act to the individual states,[9] ICC acceptance of these state-prescribed sub-accounts may be construed as recognition of the power of the states to require accounts for this own regulatory purposes independent of the scope of the Commission's authority to prescribe accounts for federal purposes.[10]

19. That Commission's conclusion that states may supplement a uniform system would not preclude a conclusion that Section 20 of the Interstate Commerce Act or Section 220 of the Communications Act forecloses states from departing from a federally prescribed accounting system by

[9]See, 49 U.S.C.A. Section 17(2); and Davis, *Administrative Law Treatise,* Ch. 3 (1978).

[10]Significantly, the FCC also has permitted state-prescribed subaccounts in the USOA books, 47 C.F.R. Section 31.01-2(f) provides the following:

> Nothing contained in the part shall prohibit or excuse any carrier or receiver or operating trustee of any carrier from subdividing the accounts hereby prescribed *in the manner ordered by any State commission having jurisdiction* or to the extent necessary to secure the information required in the prescribed reports to such commission. (Emphasis added.)

adopting accounting methods that are inconsistent with the federal system. That ICC opinion does contain language that indicates that the ICC believed such departures from uniformity would be undesirable, but the ICC did not conclude that such departures are precluded by statute.

20. Supreme Court decisions relating to Section 20 of the Interstate Commerce Act never squarely addressed the question of the extent of the states' power to prescribe accounting and depreciation rules that supplement or deviate from rules prescribed by the ICC. A telephone company did challenge certain state-prescribed depreciation requirements in *N.W. Bell Tel. Co. v. Ry. Comm'n*, 297 U.S. 471 (1936). The Court concluded that Section 20 clearly did not preclude a state commission from adopting and enforcing depreciation rules prior to the adoption of the ICC depreciation rules. The Court expressly declined to determine what effect the adoption of ICC depreciation rules would have upon the state commission's powers.

21. Inasmuch as Section 20 had never been construed to restrict state commissions from requiring carriers to keep additional records for purposes of intrastate ratemaking and court decisions in analogous contexts did not adopt an expansive interpretation of that provision, the reenactment of that language should not be interpreted to restrict state commissions from keeping such additional records in the absence of clear evidence that the 1934 Congress intended to produce that result. AT&T and GTE would infer such an intent from that Congress failure to enact a proposed subsection 220(j) that would have provided:

> Nothing in this section shall (1) limit the power of a State commission to prescribe, for the purposes of the exercise of its jurisdiction with respect to any carrier, the percentage rate of depreciation to be charged to any class of property of such carrier, or the composite depreciation rate, for the purpose of determining charges, accounts, records, or practices;

> (2) relieve any carrier from keeping any accounts, records, or memoranda which may be required to be kept by any State commission in pursuance of authority under State Law.[11]

22. This version of section 220(j) passed the House but was eliminated from the Senate bill. The revised Senate version of section 220(j) provided instead:

> The Commission shall investigate and report to the Congress whether in its opinion legislation is desirable (1) authorizing the Commission to except the carriers of any particular class or classes in any State from any of the requirements under this section in cases where such carriers are subject to State commission regulation with respect to matters to which this section relates; and (2) permitting the State commissions, in pursuance of authority granted under State Law, to prescribe their own percentage rates of depreciation or systems of accounts, records, or memoranda to be kept by carriers.[12]

23. The Conference Committee drafted a compromise that retained the House version of subsection 220(h) and substituted a new subsection 220(j) for both the House and Senate versions. The Conference Committee version of Section 220, which was enacted without further modification, also included a subsection (i) that did not parallel Interstate Commerce Act language. Subsections (h)-(j) provided:

> (h) The Commission may classify carrier subject to this Act and prescribe different requirements under this section for different classes of carriers, and may, if it deems such action consistent with the public in-

[11]S. 2910, 73d Cong., 2d Sess. Section 220(j) (February 20, 1934); H.R. 8301, 73d Cong., 2d Sess. Section 220(j) (February 27, 1934).

[12]S. 3285, 73d Cong., 2d Sess. Section 220(j) (March 8, 1934).

terest, *except the carriers of any particular class or classes in any state from any of the requirements under this section in cases where such carriers are subject to State commission regulation with respect to matters to which this section relates.* (Emphasis added)

(i) The Commission, before prescribing any requirements as to accounts, records, or memoranda, shall notify each State commission having jurisdiction with respect to any carrier involved, and shall give reasonable opportunity to each such commission to present its views and recommendations.

(j) The Commission shall investigate and report to Congress as to the need for legislation to define further or harmonize the powers of the Commission and of State commissions with respect to matters to which this section relates.

24. AT&T and GTE argue that statements by witnesses at the committee hearings both in favor of and in opposition of the original version of Section 220(j) support the position that Congress intended in dropping this provision to preempt the states for all purposes. They contend that statements by witnesses from both sides were premised on the believe that absent a provision similar to original section 220(j) the states would be bound by federal accounting and depreciation prescriptions in their local regulation. We disagree.

25. The record of the Congressional hearings indicates little more than that the supporters of original section 220(j) believed that the provision was desirable to resolve a previous unsettled point of law under the predecessor provision of the Interstate Commerce Act. This desire on the part of the state commissions to have Congress explicitly recognize the authority of the states to prescribe accounts and depreciation rates for local regulatory purposes is

reflected in the following statements of J.E. Benton, NARUC's general solicitor (emphasis added).

Section 220, which is the section giving the Commission jurisdiction to prescribe accounts and reports, also takes account of local conditions and safeguards the powers of State commissions in the matters of depreciation and of accounting regulations. *The State commissions are very solicitous that the act shall be so phrased that it cannot be construed* as imposing any depreciation regulation promulgated by the Federal Commission upon the regulatory agencies of the States.

. . . .

Ever since the power to fix depreciation rates was given to the Interstate Commerce Commission in 1920, *the State commissions have been apprehensive that when an order finally came to be fixed by a Federal Commission it would be pointed to by the utilities as depriving the State commissions thereafter of going into the question of depreciation in rate cases* . . .

. . . .

[W]e do not ask for any particular form of words, but there should go into the act a provision which makes it clear that in the administration of their laws for the regulation of rates, the State commissions shall have the power in rate cases to determine what allowances shall be made for depreciation in the rates which are fixed.

[T]he State Commissions believe that it is not in the public interest that the act shall contain a mandate to the Federal commission to fix rates of depreciation unless *it shall be made entirely clear* in the act that such determination is for the use of the Federal commission only and is not to affect the State commissions in their regulatory work.

. . . .

That section merely proposes to provide, in plain terms, that the control of intrastate telephone business as now exercised by the States, shall continue to be exercised by them without interference by the Federal Commission.[13]

26. Several witnesses opposed original section 220(j) on the various grounds that it would create the possibility of unreasonably burdening the carriers with the cost of multiple sets of books,[14] that it would destroy the uniform system of accounts[15] and that it would create conflicts in the exercise of federal and state jurisdiction.[16] Only one opposing witness, however, specifically expressed the view that the then-current law prohibited the states from prescribing accounts and depreciation rates for their own purposes, and this statement was tentative.[17]

[13]Hearings on H.R. 8301, Before the Committee on Interstate and Foreign Commerce, U.S. House of Representatives, 73d Cong., 2d Sess. (April 10, 1934), pp. 136-44 (Emphasis added.); see also, Hearings on S. 2910 Before the Committee on Interstate Commerce, United States Senate, 73 Cong., 2d Sess., (March 9-10, 13-15, 1934) pp. 178-84.

[14]See, *e.g.*, Hearings on S. 2910, p. 96; and Hearings on H.R. 8301, p. 191. (Statements of W.S. Gifford, President, AT&T.)

[15]See, *e.g.*, Hearings on S. 2910, p. 208; and Hearings on H.R. 8301, p. 96. (Letters of F. McManamy, Commissioner, ICC)

[16]See, e.g., Hearings on H.R. 8301, p. 243 (Statement of F.B. MacKinnon, President, United States Independent Telephone Association. How this version of section 220(j) would undermine the uniformity of the *federal* accounting system or result in conflict between federal and state authorities was not explained.

[17]MR. GIFFORD. [Section 220(j)] throws the whole uniform accounting of the telephone industry out of line too, as I see it. It would make it necessary to keep two sets of accounts, one for the Federal Commission and one for the State commission, because each State may provide for a different system of accounting. The States will require one system of accounting, and we will also have to keep accounts for the Federal system of accounting. I do not think it is workable.

. . . .

MR. MAPES. *Do the States now require you to keep accounts of any kind?*

MR. GIFFORD. *No.* The present law, the interstate commerce law, calls for accounts and that controls, as against the State laws.

MR. MAPES. Exclusively.

MR. GIFFORD. *Exclusively, and has since 1913, I think,* when the act was passed. I think the matter ought to be given very serious consideration before we go into that.

Hearings on H.R. 8301, pp. 191-92. (Emphasis added).

27. Even if all the witnesses who testified concerning original section 220(j) had consistently and clearly expressed the view that the states lacked authority to prescribe additional accounts and depreciation rates absent this provision, we could accord little weight to the statements given the silence contained in the Congressional reports.[18] In striking the compromise which became the law, Congress was completely silent as to its intent in eliminating the House version of Section 220(j).

28. H. Rep. No. 1918 describes the Conference provisions as follows (p. 47):

[18]Generally, statements made by interested parties as to the nature and effect of a bill are accorded to little or no weight if not incorporated into a committee report. These statements are very weak evidence that the legislature adopted the assumed interpretation, in view of the possibility that the committee believed the changes were unnecessary because the assumed interpretation was erroneous. See, *Sutherland Statutory Construction*, Section 48.10, and cases cited therein.

Similarly, contrary to the contention of AT&T, the mere existence of provisions in the Natural Gas Act, 15 U.S.C.A. Section 717(g) and the Federal Power Act, 16 U.S.C.A. Section 825(a) specifically reserving to the states the right to prescribe additional accounting regulations does little to assist its cause in this case. *See, e.g., Keifer & Keifer v. Reconstruction Finance Corp.*, 306 U.S. 381 (1939).

Section 220(j) of the Senate bill (accounts and depreciation charges) authorizes the Commission to investigate and report to Congress upon the desirability of legislation authorizing the Commission to except the carriers of any particular class or classes in any State from the requirements of the section and permitting State commissions to prescribe their own percentage rates of depreciation and systems of accounts for carriers. The House amendment (sec. 220(h)) specifically authorizes the Commission to except carriers of any particular class or classes in any State and provides (in sec. 220(j)) that the section shall not limit the power of the State commissions to prescribe percentage rates of depreciation or to require the keeping of accounts.

29. At most this legislative history indicates that the 1934 Congress was not sure whether reenactment of the Interstate Commerce Act language would or would not preempt state accounting and depreciation rules and did not choose to resolve the question at that time. One might infer that Congress believed Subsection (g) did not preempt inconsistent state commission accounting and depreciation practices. If Subsection (g) produced that effect, any further legislation to "harmonize" the powers of the regulatory commissions might be superfluous.

30. The carriers' contention that Subsection (i) demonstrates that the 1934 Congress believed it had preempted State commission accounting and depreciation rules is not persuasive. Congress undoubtedly correctly anticipated that most State commissions would not choose to create a complete system of accounts and would be vitally interested in any rules developed by this Commission. The adoption of special notice and consultation requirements does not demonstrate that Congress assumed all states would be required to adhere to all federal accounting or depreciation rules.

31. Subsections (h)-(j) indicate that the 1934 Congress wished to achieve as much uniformity as possible without coercing any state commission to use ratemaking methods it found unacceptable. This Commission has proceeded in a manner that is consistent with that purpose for nearly four decades. We have always given special consideration to the needs and views of state commissions in developing accounting and depreciation rules and most State commissions have chosen to follow most accounting and depreciation rules prescribed by this Commission. Departures have nonetheless occurred from time to time.[19] This Commission has never attempted to prevent any State commission from departing from our accounting and depreciation rules. Indeed we have expressly recognized that State commissions have a right to do so.

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[19]For example, our *Order on Reconsideration* (FCC 79-678, released November 6, 1979) with respect to our Docket 21230 decision adopting revised accounting rules for plant under construction noted that many states have adopted different accounting procedures for plant under construction. We expressly acknowledged in paragraph 9 of that order that our decision would not inhibit the desecration of the state commissioners. We said:

> As our *Final Order* in Docket 21230 makes clear, we have in no way attempted to influence, or interfere with, the rate making prerogatives of the New York PSC or any other state commission. The states remain free to establish intrastate rates on whatever lawful basis they choose. The fact that separate accounting information will have to be retained to accomplish this and the fact that the gathering and retention of this information may involve additional cost does not, in our view, involve any significant interference with state control over intrastate rates.

States have also departed from accounting practices we have prescribed in other situations. Florida requires full nomalization of taxes, this Commission does not. Many states have authorized or required a deferral of expenses when we do not.

32. NARUC correctly notes that this Commission previously has recognized that states are not obligated to follow F.C.C. prescribed accounts in intrastate ratemaking proceedings. Thus, *In the Matter of Amendment of Part 31, Uniform Systems of Accounts for Class A and Class B Telephone Companies*. 68 F.C.C. 2d 902, 906-07 (1978), we stated:

> It should be pointed out that we are not in any way attempting to influence the intrastate ratemaking decisions the several state commissions may make in this area. Of course, they are free to adopt the same ratemaking treatment for plant under construction and interest during construction as we adopted in Docket 19129, or they may prefer to follow a different treatment. We are familiar with at least one state that by statute must follow a different treatment. We do not believe, nor is it intended, that the accounting changes adopted in this proceeding impinge upon the ratemaking prerogatives of any state commission. Further, as everyone is aware, different treatment is already given to a number of items for intrastate vs. interstate ratemaking as well as among the several state commissions for intrastate ratemaking.

See also, *Notice of Proposed Rulemaking*, in CC Docket No. 79-105, at para. 7; and 47 C.F.R. Section 31.01-2(f).

33. Telephone companies have rarely challenged past state commission departures from accounting or depreciation rules prescribed by this Commission. Such challenges have not been successful. Pacific Telephone did challenge a California Public Utility Commission rate order on the grounds that it was invalid because it was based upon depreciation methods that departed from methods prescribed by this Commission. The California Supreme Court

rejected that contention in *Pacific Tel. and Tel. Co. v. California*, 401 P.2d 353, 372-73 (1965).[20]

34. Thus, AT&T and GTE are asking us to repudiate nearly forty years of administrative practice and applicable state court precedents by adopting an interpretation of Section 220 that would require an unwilling state commission to follow all accounting and depreciation methods prescribed by this Commission. A very compelling showing would be required to persuade us to follow such a course.

35. GTE appears to argue that the existence of such state accounting and depreciation departures would make impossible a federal scheme of accounting and depreciation prescriptions. Past departures have not produced such an effect. If carriers maintain the records we require for purposes of interstate ratemaking, federal regulation will not be frustrated if carriers maintain additional records for other purposes.

36. Unlike GTE, AT&T appears to concede this point. AT&T argues, however, that the sanctioning of state accounting and depreciation departures from the prescriptions contained in the *First Report and Order* would permit the states to burden the carriers with the costs of maintaining multiple sets of records. We, of course, are not free to preempt the states on the theory that they otherwise may impose administrative costs on the carriers in the course of engaging in intrastate ratemaking.

37. Our analysis of Section 220 is supported also by Section 2(b) of the Act, 47 U.S.C. § 152(b), which provides in pertinent part that "nothing in this Act shall be

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[20]The Florida Public Service Commission concluded that it is not required to use depreciation methods prescribed by this Commission. *Southern Bell Telephone and Telegraph Co.*, 66 PUR 3d 1, 57-58 (1966).

construed to apply or to give the Commission jurisdiction with respect to (1) charges . . . for or in connection with intrastate communication service by wire or radio of any carrier . . ." Section 2(b) does not prohibit preemption of state regulatory actions that might interfere with or tend to frustrate policies or rules we have adopted to carry out statutory objectives with respect to interstate and foreign communications. *North Carolina Utilities Commission v. FCC,* 552 F.2d 1036 (4th Cir. 1977), *cert. denied* 434 U.S. 874 (1977) [hereinafter cited as *NCUC II*]; *North Carolina Utilities Commission v. FCC,* 537 F.2d 787 (4th Cir. 1976), *cert. denied* 429 U.S. 1027 (1976); *Puerto Rico Telephone Co. v. FCC,* 553 F.2d 694 (1st Cir. 1977); *People of California v. FCC,* 185 U.S. App. D.C. 217, 567 F.2d 282 (1966), *cert. denied* 325 U.S. 837 (1966). But where state regulation is reconcilable with federal policies or rules, there is no occasion for us to override state agency actions in furtherance of legitimate state regulatory objectives. Section 2(b) makes clear that Congress did not intend this Commission to foreclose state ratemaking actions unless those actions imperiled "important interests of national communications policy. . . ." *NCUC II,* 552 F.2d at 1047. We have found in this instance that federal regulation will not be frustrated if carriers maintain additional records for intrastate ratemaking purposes.

Ordering Clauses

38. Accordingly, IT IS HEREBY ORDERED THAT the petition for clarification of the National Association of Regulatory Utility Commissioners, filed April 30, 1981, IS GRANTED to the extent reflected herein.

39. IT IS FURTHER ORDERED THAT the petition for reconsideration of the People of the State of California and the Public Utilities Commission of the State of California, filed April 30, 1981, IS DISMISSED as moot.

40. IT IS FURTHER ORDERED THAT the Secretary of the Federal Communications Commission shall cause this *Memorandum Opinion and Order* to be published in the Federal Register and in the Federal Communications Reports.

41. IT IS FURTHER ORDERED THAT the Secretary shall cause to be served on each party of record in CC Docket No. 79-105 and each state commission having jurisdiction over intrastate communication service a copy of this *Memorandum Opinion and Order.*

FEDERAL COMMUNICATIONS COMMISSION*

/s/ William J. Tricarico
Secretary

*See attached joint dissenting statement of Commissioners Joseph R. Fogarty and Anne P. Jones.

April 1, 1982

Joint Dissenting Statement
of
Commissioners Joseph R. Fogarty and Anne P. Jones

In Re: Expensing of Station Connections (CC Docket No. 79-105)—Petitions for Clarification and Reconsideration.

We dissent from today's majority decision that the First Report and Order in this proceeding does not preempt State regulators from imposing accounting and depreciation rules for inside wiring which are inconsistent with those prescribed by this Commission.

In its *First Report and Order* the Commission required that account 232 of the Uniform System of Accounts be separated into two subclasses, "Station Connections—inside wiring" and "Station Connections—Other". We further required that the existing investment in Station Connections—inside wiring be amortized over a period of ten years, which represents an accelerated depreciation in contrast to past practices, and that all new investment for inside wiring be expensed rather than capitalized.

Because we wished to ameliorate the effect such an expensing plan could have upon local rates, the Commission required that expensing take place over a four-year period. In discussing this phase-in approach, the Commission stated that ". . . we want to allow all carriers and *state regulatory agencies* as much flexibility as possible in shifting from capitalization to expensing. Hence, for those carriers who feel that a flash-cut approach will not be too disruptive to their operations and who gain state regulatory approval, *we will allow them* to use a flash-cut approach".[1] It is clear from this discussion that the Commission intended its decision to be binding upon the States. Since only approxi-

[1]*First Report and Order,* 85 FCC 2d 818, 829 (Emphasis added).

mately one-quarter of inside wiring costs are apportioned to the interstate jurisdiction, a phase-in which embraced only these costs would result in about 6¼, 12½, 18¾ and 25 percent of all new inside wiring costs being expensed instead of capitalized in each of the four years respectively. Surely this is not what the Commission intended. It would be nonsensical to order such a time-and resource-consuming process to achieve only such a limited effect.

We also intended the decision in our *First Report and Order* to be binding upon the States for the sound policy reason that telephone operating companies need to obtain a more rapid recovery of capital in order to modernize their plant to meet consumer needs and increased competition in the future.

Further, the FCC may ultimately order the complete detariffing and deregulation of inside wiring. The Commission anticipated this possibility in the *First Report and Order* when we said:

> ". . . we believe that the final answer rests not with accounting changes but rather with the ultimate deregulation of this activity. This is nothing more than a logical extension of the recommendations made by parties, our decision in Docket 20828 and our overall regulatory scheme to introduce competition whenever technological and economic circumstances are conducive to such a change."[2]

As the Commission has seen in the deregulation of customer premises equipment, asset valuation is a very difficult problem. If inside wiring is similarly deregulated, asset valuation will be made more difficult if this account is not capped. Furthermore, if there are two sets of accounting books required (one Federal and one State), any eventual detariffing of the inside wiring account will

[2]Ibid, 827.

be made all the more difficult, since inside wiring must be deregulated *in toto* or not deregulated at all (unless the Commission contemplates deregulating only the first one-fourth of the length of wire between the protector block and the wall outlet).

Disregarding these important considerations of Federal policy, the majority has decided that the Commission did not intend to preempt inconsistent State accounting and ratemaking practices and procedures with respect to the Station Connections-inside wiring account. At the same time, the majority allows that the Federal Communications Act—and, in particular, Section 2(b) thereof—"does not prohibit preemption of state regulatory actions that might interfere with or tend to frustrate policies or rules we have adopted to carry out statutory objectives with respect to interstate and foreign communications."[3] The continued capitalization of inside wiring by State regulatory authorities will in fact imperil and frustrate "important interests of national communications policy . . ."[4]—enhanced capital recovery and the effective implementation of any ultimate FCC decision on ordering the detariffing and deregulation of inside wiring[5].

We would not—and the majority should not—"defer to the States" on critical capital recovery issues affecting the continued viability and competitiveness of our Nation's telephone industry in providing increasing essential interstate, as well as intrastate, facilities and services. This

[3]MO&O, para. 37 (Citations omitted).

[4]*North Carolina Utilities Commission v. FCC*, 552 F.2d 1036, 1047 (4th Cir. 1977), *cert. denied* 434 U.S. 874 (1977).

[5]Several State commissions have already acted to deny the application of FCC policy on inside wiring and related depreciation at the State level, and others appear to be in the process of following suit. Alabama (Sept. 4, 1981), Nebraska (Sept. 1, 1981), South Dakota (Feb. 2, 1982), and Missouri (Nov. 27, 1981) have disapproved carrier filings seeking the expensing of inside wiring.

Commission has thrust the telephone industry into the brave new world of telecommunications competition and in doing so has overidden the strenuous and in many cases intransigent objections of many State commissions. It is therefore oddly inappropriate for this same Commission now to be so reticent about preempting the State jurisdictions from denying the industry the capital recovery necessary for its full and fair participation in this new competitive world. Here, the Commission curiously appears to have lost the courage of its pro-competitive convictions.

Because the majority's decision is inconsistent with the clear preemptive thrust and intent of the Commission's *First Report and Order* in this proceeding and, further, fails to recognize and support the integrity of our pro-competitive policies, we dissent.

Before the
Federal Communications Commission
Washington, D.C. 20554

CC Docket No. 79-105

In the Matter of

Amendment of Part 31, Uniform System of Accounts
for Class A and Class B Telephone Companies,
of the Commission's Rules and Regulations
with respect to accounting for station connections,
optional payment plan revenues and related capital costs,
customer provided equipment and sale
of terminal equipment.

ERRATUM

Released: April 30, 1982

The Memorandum Opinion and Order, FCC 82-155, released April 27, 1982, in the above-entitled matter is corrected to include Commissioner Rivera dissenting after the phrase "By the Commission".

FEDERAL COMMUNICATIONS COMMISSION

/s/ William J. Tricarico
William J. Tricarico
Secretary

Before the
Federal Communications Commission
Washington, D.C. 20554

CC Docket No. 79-105
RM-3017

In the Matter of
Amendment of Part 31, Uniform System of Accounts
for Class A and Class B Telephone Companies,
of the Commission's Rules and Regulations
with respect to accounting for station connections, optional
payment plan revenues and customer provided equipment
and sale of terminal equipment.

Petition for Declaratory Ruling on Question
of Federal Preemption Involving Order of the Public
Utilities Commission of Ohio in Conflict
with (i) FCC Prescriptions Under Section 220 of the
Communications Act and (ii) Established FCC Policies

MEMORANDUM OPINION AND ORDER

Adopted: *December 22, 1982* Released: *January 6, 1983*

By the Commission: *Commissioner Fogarty issuing a separate statement.*

1. The Commission has before it a Petition for Reconsideration filed on June 7, 1982, by the American Telephone and Telegraph Company, on behalf of itself and the associated Bell System Operating Companies (AT&T). AT&T seeks reconsideration of the Commission's decision in *Amendment of Part 31,* 89 FCC 2d 1094 (1982) (hereinafter cited as *Preemption Order*), in which the Commission determined that Sections 220(a) and 220(b) of the Communications Act of 1934, as amended, 47 U.S.C. 220(a) and

220(b), did not preempt state commissions from applying different accounting and depreciation procedures for purposes of intrastate ratemaking proceedings[1] The *Preemption Order* was a reconsideration of *Amendment of Part 31,* 85 FCC 2d 818 (1981) (hereinafter cited as *Expensing Order*).

2. The Commission also has before it a Petition for Declaratory Ruling filed on June 7, 1982, by General Telephone Company of Ohio (GTE of Ohio). This petition requests that the Commission preempt an order of the Public Utilities Commission of Ohio (Ohio) that denied GTE of Ohio the same depreciation rates for intrastate purposes as had been prescribed by this Commission. GTE of Ohio contends that Section 220(b) established the rate prescribed by the Commission as the only depreciation rate the company could utilize.

3. The Commission established a joint reply period for the two petitions, utilizing the pleading cycle for comments in response to the Petition for Reconsideration, and allowed parties to cross-reference their pleadings where appropriate. In addition to pleadings filed by the petitioners and the GTE parties, comments or reply comments were filed by the Arkansas Public Service Commission (Arkansas), Ohio, the People of the State of California and the Public Utilities Commission of the State of California (California), the Virginia State Corporation Commission (Virginia), the National Association of Regulatory Utility Commissioners

[1]On June 8, 1982, GTE Service Corporation, on behalf of itself, United Telephone System, Inc., and Continental Telecom, Inc. (hereinafter referred to as GTE), filed a Petition for Clarification of the Commission's *Preemption Order.* This petition was dismissed as untimely. *Amendment of Part 31,* Mimeo No. 4766 (released June 24, 1982). However, the Commission stated that it would consider the substance of the petition in connection with AT&T's petition.

(NARUC), the United States Independent Telephone Association (USITA), the Office of Consumers' Counsel, State of Ohio (Consumers' Counsel), the United States Telephone System Inc. and the Idaho Public Utilities Commission (Idaho). A summary of the comments is contained in Appendix A. Below we consider the issues raised on reconsideration, after which we shall consider the question presented by GTE of Ohio's Petition for Declaratory Ruling.

I. *Background*

4. In *Docket No. 19129,* 64 FCC 2d 1, 54-56 (1977), we concluded that it would be desirable to have the causative rate payer bear the costs associated with station connections. We directed AT&T to file a plan for accomplishing this objective. Following AT&T's submission we initiated this proceeding, albeit with a somewhat different approach for modifying the accounting for station connections than proposed by AT&T.

5. After reviewing the comments, we concluded that the drop, block and protector portion of station connections should not be included in any accounting or regulatory revisions. We also concluded that our objective of placing the costs of station connections on the cost causative customer could not be achieved by means of an accounting change alone. This is so because costs associated with the provision of inside wiring must be apportioned between the federal and state jurisdictions as long as inside wiring is provided as a tariffed service subject to dual jurisdiction. Complete unbundling could be achieved by requiring inside wiring to be provided on a detariffed basis, as was done with customer premises equipment. Accordingly, we initiated a further inquiry to explore the detariffing concept further, *Amendment of Part 31,* 86 FCC 2d 885 (1981).

6. Nevertheless, we concluded that changes in accounting and depreciation procedures that would begin expens-

the inside wiring portion of the station connection account would be in the public interest, and would facilitate the deregulation of the provision of inside wiring if the Commission should later decide to take that approach. The principal changes required that future costs of installing inside wiring and similar costs be included as an expense in Account 605, Repair of Station Equipment. Such costs were previously capitalized in Account 232, Station Connections. The expensing of these costs would be phased in over a four year period unless a carrier obtained state commission approval to expense one hundred percent immediately. The *Expensing Order* also required that the present net investment in inside wiring and the investment capitalized during the phase-in period be amortized over a ten year period. These expensing and amortization rules replaced the depreciation procedures that had previously applied to the inside wiring portion of the station connections account.

7. On reconsideration, we concluded that the *Expensing Order* was not intended to preempt state commissions from utilizing other depreciation or accounting procedures for intrastate ratemaking proceedings, unless such preemption occurs as a matter of law. Our discussion was based in part on an assumption that most or all of the state commissions would follow our lead. We also indicated that Section 220 does not preclude state commissions from departing from accounting and depreciation rules prescribed by this Commission for purposes of regulating intrastate communications services. In reaching this conclusion, we reviewed Section 20(5), the Interstate Commerce Act predecessor of the accounting and depreciation provisions contained in Section 220. We concluded that nothing in the history of Section 20(5) provided any indication of whether that provision had been intended to preempt state commissions from prescribing divergent depreciation rates when the Interstate Commerce Commission (ICC) had prescribed a rate. We stated:

> [i]nasmuch as Section 20 had never been construed to restrict state commissions from requiring carriers to keep additional records for purposes of intrastate ratemaking and court decisions in analagous contexts did not adopt an expansive interpretation of that provision, the reenactment of that language should not be interpreted to restrict state commissions from keeping such additional records in the absence of clear evidence that the 1934 Congress intended to produce that result.

Preemption Order, supra at 1102.

8. We also reviewed the legislative history of the Communications Act and concluded that Congress had been uncertain of the preemptive effect of reenacting the Interstate Commerce Act language and that it apparently did not want to resolve the question at that time. We concluded that Congress had been attempting to obtain as much uniformity as possible without coercing any state commission to use ratemaking methods which it might find unacceptable. We found that we had proceeded in a manner consistent with this purpose for nearly four decades, noting that we had recognized divergent practices by state commissions from time-to-time. The language of Section 2(b)(1) was found to support the interpretation that state commissions are not precluded from applying different accounting and depreciation procedures from this Commission. The *Preemption Order* concluded by finding that nothing in the Act precluded us from preempting state commission actions that might interfere with or tend to frustrate policies or rules we have adopted to carry out statutory objectives with respect to interstate or foreign communications, but we also found that federal regulation would not be frustrated if carriers maintain additional records for intrastate ratemaking purposes.

II. *Discussion*

9. The question presented in the reconsideration petition is a clearly delineated controversy over whether Section 220(b) preempts state depreciation prescriptions that are inconsistent with the rates prescribed for classes of property by this Commission, or, whether Section 2(b)(1) or Section 221(b) reserve to the states the right to prescribe their own depreciation rates for intrastate regulatory purposes. Alternatively, it is argued that the Commission should preempt inconsistent state depreciation rates pursuant to its authority to preempt state actions which would frustrate or interfere with the accomplishment of federal objectives. *See North Carolina Utilities Commission v. FCC,* 537 F.2d 787 (4th Cir. 1976), *cert. denied,* 429 U.S. 1027 (1976) (hereinafter cited as *NCUC I*). The *Preemption Order* was the first time the Commission had squarely addressed the preemptive effect of a prescribed depreciation rate, despite having prescribed rates for more than thirty years. No federal court has addressed the question of the preemptive effect of a Commission prescribed depreciation rate.[2]

10. It is argued that the Commission erred in the earlier decision by concentrating on Sections 220(a) and 220(g) rather than properly analyzing Section 220(b), the provision dealing directly with depreciation. A careful review of AT&T's and GTE's pleadings and a thorough reevaluation

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[2]The United States Supreme Court has held that state commissions may prescribe depreciation rates where the empowered federal commission has not prescribed rates. *Northwestern Bell Telephone Co. v. Nebraska State Railway Comm.,* 297 U.S. 471 (1936). The Court specifically reserved judgment on the effect of prescribed rates by the federal commission.

of the entire question of the Commission's depreciation jurisdiction leads to the conclusion that the evaluation in the *Preemption Order* did not sufficiently consider the effect of Section 220(b). Accordingly, we shall undertake to evaluate anew the scope of the Commission's jurisdiction under Section 220(b).

11. Before turning to the analysis of the statutory provisions, it is necessary to understand the relationship between capitalizing and expensing a transaction or economic event. When an event is capitalized, its cost is recorded on the company's books to be recovered over some future period through depreciation charges to operating expense. Depreciation as used here is an accounting convention for allocatively spreading the original cost, less net salvage, over the useful life of a capital asset. Thus, for there to be depreciation there must be costs that are to be recovered over more than one accounting period. However, when the decision to expense is made, all costs are to be recovered at one time. Thus, the decision to expense is a determination that there is no category of asset for which depreciation expense will be allowed. It is therefore clear that the decision to commence expensing the inside wiring portion of station connections involves questions of depreciation policy

12. The law is clear that federal regulation should not be presumed to preempt state regulations without clear evidence of either congressional design to preempt the field or that state regulatory activities would obstruct the accomplishment and execution of the full purposes and objectives of Congress. *Florida Lime and Avocado Growers, Inc. v. Paul,* 373 U.S. 132, 141 (1963), *Hines v. Davidowitz,* 312 U.S. 52, 67 (1941). Our review reveals that both crite-

ria are satisfied in this case. In reaching this conclusion we analyzed the language of Section 220, the legislative history, relevant court cases, and our regulatory objectives.

A. *Statutory Language*

13. The Commission's express jurisdiction with respect to depreciation is set forth in Section 220(b). That section provides:

> The Commission shall, as soon as practicable, prescribe for such carriers the classes of property for which depreciation charges may be properly included under operating expenses, and the percentages of depreciation which shall be charged with respect to each of such classes of property, classifying the carriers as it may deem proper for this purpose. The Commission may, when it deems necessary, modify the classes and percentages so prescribed. Such carriers shall not, after the Commission has prescribed the classes of property for which depreciation charges may be included, charge to operating expenses any depreciation charges on classes of property other than those prescribed by the Commission, or, after the Commission has prescribed percentages of depreciation, charge with respect to any class of property a percentage of depreciation other than that prescribed therefor by the Commission. No such carrier shall in any case include in any form under its operating or other expenses any depreciation or other charge or expenditure included elsewhere as a depreciation charge or otherwise under its operating or other expenses.

14. The plain language of the statute is express and unequivocal. Section 220(b) says the Commission "shall" make depreciation prescriptions, and that carriers "shall not" charge depreciation different than that prescribed

by the Commission. That this preempts inconsistent state action is further indicated in Section 220(h) which gives the Commission discretion to "except" carriers from the requirements of Section 220 "where such carriers are subject to state commission regulation."

15. The requirement of Section 220(i) that states be given an opportunity to comment before the Commission prescribes "any requirements as to accounts, records and memoranda" is consistent with an interpretation that states are preempted when the Commission has acted in the depreciation area. By providing that states be given notice, Congress ensured that state needs for accounts, records and memoranda brought to the Commission's attention would be considered. Such a procedure assures that the states' needs and legitimate interests are met.

16. In setting the duties of the Commission and the prohibitions on the carriers subject to the Act, Congress spoke of depreciation in general terms without any attempt to make distinctions between either "intrastate" or "interstate" property. This is significant because when Congress wanted to make such distinctions in the Act it did so. See, *e.g.*, 47 U.S.C. 221(c) and (d), and 410(c). The fact that Congress did not make such a distinction here indicates that it intended no distinction.

17. Taken as a whole, the language of Section 220 appears clearly to preempt the states in connection with depreciation expense determinations and the related accounting. The language strongly implies that the states may not depart from depreciation rules prescribed by the FCC unless the Commission in its discretion allows them to do so. Otherwise, the federal statute would govern state depreciation practices in form only, allowing the states to treat substantive depreciation matters as they

might choose. While that might be a plausible construction of Section 220, after full analysis we do not believe that Congress intended such a feeble gesture. There would be little purpose to require the carriers to keep all their books pursuant to an FCC prescription, and then allow the states to require the carriers to follow inconsistent depreciation practices. Instead, the language of the section and the comprehensive treatment given to this matter by the Congress demonstrate that more was intended. Accordingly, we find that the statutory language indicates that FCC depreciation prescriptions are to be followed in both the federal and state jurisdictions unless the FCC provides otherwise. As demonstrated below, this construction is also consistent with the legislative history.

B. *Legislative History*

18. In the *Preemption Order* we found that the legislative history of Section 220 was inconclusive and at most indicated that Congress was "not sure" about the preemptive effect of the new legislation. 89 FCC 2d at 1106. However, the reconsideration petition and comments supporting it show that Congress believed that the language ultimately adopted would preempt the states from prescribing depreciation rates for subject carriers when the Commission had prescribed rates.

19. In our *Preemption Order,* we observed that Section 220 of the Communications Act had been adopted from Section 20 of the Interstate Commerce Act, and our review of the few ICC cases touching upon preemption did not reveal the ICC to have possessed the kind of broad preemptive power now urged by GTE and AT&T. However, after reviewing the pre-1934 cases again, we find that, while not dispositive, they lean more toward GTE and AT&T's views than against them.

20. The closest the ICC came to delineating its position on this matter came in *Depreciation Charges of Telephone Companies,* 118 I.C.C. 295, 332 (1926), where it said:

> It seems to be well established that where a local telephone company undertakes to originate or deliver toll messages, and most of them do so undertake, practically all of its property is open for use in interstate commerce and at any time may be so used. Under such circumstances, no doubt would seem to exist as to the power of Congress to regulate the accounting practices of such companies with respect to their property, including the accounting for depreciation.

In the *Preemption Order* we focused on the fact that the ICC had not actually prescribed depreciation rates and thus there was uncertainty regarding the ICC's actual authority. However, after reviewing that case again we find that the better and more sensible interpretation is that if the ICC had prescribed depreciation rates, the state commissions would have been precluded from prescribing rates that diverged from those it prescribed. We cited *Smith v. Illinois Bell Tel. Co.,* 282 U.S. 133, 159 (1930), in the *Preemption Order* as supporting our conclusion that the ICC decision did not preempt the states. In that decision the Supreme Court held that absent ICC action prescribing depreciation rates, Section 20(5) did not preclude states from prescribing depreciation rates. Since the ICC proceeding did not actually prescribe depreciation rates, but only began a proceeding looking toward the ultimate prescription of depreciation rates, there were no depreciation rates prescribed that could have preempted state-prescribed depreciation rates. Thus *Smith* only stands for the proposition that until the ICC actually prescribed rates, there was no basis for preempting the

states. It did not reach the question of whether Section 20(5) would preempt the states if the ICC prescribed depreciation rates.[3]

21. At the hearings pertaining to the Communications Act the then chairman of the ICC indicated his belief that the ICC depreciation rulings would govern both federal and state depreciation practices:

> Paragraph (j) . . . should be most carefully considered. It unquestionably directly conflicts with, and destroys the uniformity of systems of accounts and depreciation accounting required by the preceding provisions of the section. That is not true under the present law.[4]

22. Other witnesses who appeared at the hearings repeated the same view. See statements of Mr. Gifford,[5] Mr. Benton,[6] and Dr. Irvin Stewart.[7]

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[3]Similarly, *Interstate Commerce Commission v. Goodrich Transportation Co.*, 224 U.S. 194 (1912) and *Kansas City Southern Ry. Co. v. I.R.S.*, 52 F. 2d 372 (8th Cir. 1931) do not appear to have any pertinance to the issue at hand. As noted in 89 FCC 2d at 1099, *Goodrich* did not raise any question with respect to the effect of ICC accounting rules upon activities not subject to ICC rate regulation. The *Kansas* holding simply reconciles two federal statutes, the Internal Revenue Code and the Interstate Commerce Act. It did not purport to establish new law on state preemption.

[4]Ltr. of F. McManamy, Hearings on S. 2910, p. 208.

[5]Hearings on H.R. 8301, pp. 191-192 (See 89 FCC 2d at 1105, fn. 17). The *Preemption Order* had indicated that Mr. Gifford's preemption views were tentative. However, careful review of that testimony reveals that Mr. Gifford's uncertainty may have concerned the date Section 20(5) was enacted, not preemption.

[6]Hearings on S. 2910, 73rd Cong., 2d Sess., p. 181 (1943).

[7]Hearings on H.R. 8301, 73rd Cong., 2d Sess., p. 17 (1934).

23. The *Preemption Order* relied heavily on the "silence contained in the Congressional Reports," 89 FCC 2d 1105, in concluding that the legislative history did not support a finding that Section 220 was intended to preempt state commissions from prescribing their own depreciation rates for intrastate purposes. However, a reexamination of the legislative history in light of the comments on reconsideration indicates that the committee reports accompanying the bills did contain language indicating that the committees believed that the predecessor provision had preempted the states. The House Report, in discussing the Section 220(j) provision (which was not adopted) that would have reserved jurisdiction over depreciation rates to the states for purposes of intrastate ratemaking, stated that the provision was "responsive to the requests of the State commissions that the present law be *changed so as to permit* those bodies to exercise, for State purposes, certain jurisdiction over . . . depreciation accounting."[8]

24. In remarks on the House floor, Representative Rayburn, Chairman, House Committee on Interstate and Foreign Commerce explained Section 220 of the proposed bill as follows:

> [p]aragraphs (a) to (g), relating to accounts records, memoranda, and depreciation, is based upon sections

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[8]H.R. Rep. No. 1850, 73rd Cong., 2d Sess. 7 (1934) (emphasis added). The section (j) proposed by the House would have provided: "Nothing in this section shall (1) limit the power of a State commission to prescribe, for the purposes of the exercise of its jurisdiction with respect to any carrier the percentage rate of depreciation to be charged to any class of property of such carrier, or the composite depreciation rate, for the purpose of determining charges, accounts, records, or practices; (2) relieve any carrier from keeping any accounts, records, or memoranda which may be required to be kept by any State commission in pursuance of authority granted under State Law." H.R. 8301, 73rd Cong., 2d Sess. Section 220(i) (February 27, 1934).

20(5) to (8) of the Interstate Commerce Act with *changes necessary to permit State commissions to prescribe* the systems of accounts for the intrastate operation of carriers. Paragraphs (h) to (j) are new . . . *paragraph (j) removes any limitation upon the power of a State commission to prescribe, for the purposes of the exercise of its jurisdiction, rates of depreciation.* The last three paragraphs named were placed in the bill at the request of the State commissions which feel that their task of regulating intrastate communications will be greatly facilitated by the adoption of these paragraphs.[9]

25. The Senate version of Subsection (j) took a totally different approach than the House version. It called "for investigation and report to Congress instead of immediately turning over these matters to the State." S. Rep. No. 781, 73rd Cong., 2d Sess. 5 (1934).[10] The version of Section 220(j) finally enacted was the result of agreement in the conference committee. The conferees agreed to adopt the House provisions as to Sections 220(h) and (i), but decided against the House Section 220(j), proposal to remove any limitation upon the power of states to prescribe rates of depreciation. Instead, Section 220(j) was modified

[9]78 Cong. Rec. 10314 (1934) (emphasis added).

[10]The Senate version of Section 220(j) provided: "The Commission shall investigate and report to the Congress whether in its opinion legislation is desirable (1) authorizing the Commission to except the carriers of any particular class or classes in any State from any of the requirements under this section in cases where such carriers are subject to State commission regulation with respect to matters to which this section relates; and (2) permitting the State commissions, in pursuance of authority granted under State Law, to prescribe their own percentages rates of depreciation or systems of accounts records, or memoranda to be kept by carriers." S. 3285, 73rd Cong., 2d Sess. Section 220(j) (March 23, 1934).

along the lines of the Senate proposal to require the Commission to "investigate and report to Congress as to the need for legislation to define or further harmonize the powers of the Commission and of State commissions with respect to other matters to which this section relates." Conf. Comm. Rep. No. 1918, 73rd Cong. 2d Sess. 17 (1934). The obvious inference to be drawn is that the conferees were not prepared at that time to allow the states to prescribe depreciation rates different than those established at the federal level, but that matter might be considered later if the report required by Section 220(j) indicated it to be appropriate.

26. The hearing testimony and Committee reports therefore indicate that the language being recodified from Section 20(5) of the Interstate Commerce Act preempted the state commissions' jurisdiction over depreciation. The rules of statutory construction provide that where Congress reenacts a provision from an existing statute, it intends that the construction applicable to the existing provision apply as well to the new provision.[11] The legislative history thus supports the actual language of Section 220(b) and indicates that Congress intended to preempt state commission jurisdiction over depreciation rates for subject carriers when it recodified the language from the Interstate Commerce Act. Accordingly, we conclude that the analysis of the legislative history contained in the comments of AT&T and GTE accurately represents the intent of Congress and that the more persuasive reading of the legislative history supports the construction that Section 220(b) preempts inconsistent state action where the Commission has prescribed depreciation rates for a carrier.

[11]Courts have given weight to interpretations of the Interstate Commerce Act in interpreting the Communications Act. See, *e.g., American Telephone and Telegraph Company v. FCC,* 487 F.2d 865 (2d Cir. 1973).

C. *Administrative and Court Decisions*

27. The *Preemption Order* cited *Accounting Rules for Telephone Companies,* 203 ICC 13 (1934), as evidence that the FCC could not preempt state depreciation practices. There the ICC recognized that states might have additional accounting needs and indicated that it had permitted state-prescribed sub-accounts within the federally-required books of account. However, the adoption of a blanket subdivision rule does not lead to the conclusion that federally adopted accounting and depreciation rules are not preemptive. Rather, it reflects an awareness that state commissions may have special data requirements to properly administer their regulatory policies which may require additional detail beyond that prescribed by the federal agency. A subdivision rule, however, does not permit what is accounted for as an expense to be capitalized in the guise of subdividing an expense account. While we may allow subdivisions of accounts, we will not allow inconsistent accounting or depreciation methods unless such practices are otherwise consistent with the public interest. Any other policy would obliterate the prescriptive effect of our adoption of a uniform system of accounts.

28. In fact we have approved variations from the prescribed uniform system of accounts. For example, our rules give carriers blanket authority to subdivide certain prescribed accounts "provided such subdivisions do not impair the integrity of the accounts prescribed." 47 C.F.R. 31.01-2(d)(1). C.F. 31.01-2(f), authorizing carriers to subdivide accounts "in the manner ordered by any state commission having jurisdiction. . . ." We also have approved state commission rate making treatment of plant under construction different from that adopted by us. See 89 FCC 2d at 1107.

29. There may well have been some instances of inconsistent state treatment of depreciation in the past. However, we do not seek controversy unless it is necessary to protect vital federal interests. Either such instances did not come to our attention or they may not have appeared threatening to federal interests.[11] In the past the communications marketplace was typified by monopoly conditions and life and salvage factors underlying the state rates were generally very similar, if not identical, to those used by the Commission. In that environment, it was not essential that the Commission assert all the authority granted it. See *Computer and Communications Industry Association v. FCC,* No. 80-1471 (D.C. Cir. November 12, 1982). As discussed, *infra.,* in the more competitive conditions prevailing today, the utilization of proper methods and rates is more critical if the proper incentives are to be created to insure that the marketplace will function efficiently to bring the benefits of that competition to the ratepayers of this country. Therefore, where it is necessary to protect important federal policies against frustration by inconsistent state actions, we will exercise the full breadth of our depreciation powers. *See* para. 14 above.

30. Nor is there any merit to the argument that federal preemption of depreciation practices constitutes intrastate ratemaking which might run afoul of 47 U.S.C. 152(b). Section 220(b) only prohibits the states from setting depreciation rates for telephone property inconsistent from those prescribed by the FCC. It does not require that any particular tariff for intrastate service be accepted by the state commissions. The setting of depreciation rates and classes

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[11]*Pacific Telephone and Telegraph Company v. California,* 401 P.2d 353 (1965), was cited in the *Preemption Order* to support non-preemption. However, the California Supreme Court did not analyze Section 220(b) or its legislative history and its determination is therefore unpersuasive.

of depreciable property only resolves a single issue impacting the ratemaking process. It does not restrict the state commission's broad discretion in setting charges for individual services. In any event, Section 2(b) of the Act, 47 U.S.C. 152(b), has a well defined purpose which would not be implicated here: "to restrain the Commission from interfering with those essentially local incidents and practices of common carriage by wire that do not substantially encroach upon the administration and development of the interstate telephone network." *NCUC I, supra* at 794 n.6. Here the setting of depreciation rates is not an essentially local incident or practice and it has substantial effects upon the administration and development of the interstate telephone network.[13]

D. *Preemption Under Federal Supremacy*

31. Even if one were to assume that Section 220(b) did not automatically preempt the states whenever this Commission has acted, federal preemption of inconsistent state depreciation would be justified in this case to avoid frustration of validly adopted federal policies. The Fourth Circuit has stated:

> We have no doubt that the provisions of section 2(b) deprive the Commission of regularly power over local services, facilities and disputes that in their nature and effect are separable from and do not substantially affect the conduct or development of interstate communications. But beyond that, we are not persuaded that section 2(b) sanctions any state regulation, formally restrictive only of intrastate communication, that in effect encroaches substantially upon the Commission's authority under sections 201 through 205.

NCUC I, supra at 793. To the same effect, see *Computer and Communications Industry Association v. FCC, supra* at 35.

32. The D.C. Circuit recently addressed the preemption question, observing:

> We fail to see any distinction in this case between preemption principles applicable to state ratemaking authority and those applicable to other state powers. The operative principle [is that] . . . preemption of state tariffs on CPE is justified because state tariffs would interfere with the consumer's right to purchase CPE separately from transmission service and would thus frustrate the validly adopted federal policy.

Id. at 38. The court went on to find that conflicting state regulation may be preempted even though there is some indirect effect on state ratemaking discretion, noting:

> the Act itself does not distinguish between authority over rates and authority over other aspects of communications. Sections 2(a) and (b) of the Act allocate federal and state authority with regard to both "charges [and] . . . facilities." Therefore, conflicting federal and state regulations regarding dual use CPE are no more acceptable under the Act when equipment rates are involved, as here, than when interconnection policies are involved, as in the *NCUC* cases.

Id. at 38-39.

33. The provision for adequate capital recovery is important to "make available, so far as possible, to all

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[13]Nor is federal preemption of depreciation practices inconsistent with 47 U.S.C. 221(b). Section 221(b) was intended to reserve state jurisdiction over exchange rates where exchange boundaries extend over two states. That provision was not intended to create new reservations to the states beyond that contained in Section 2(b) and the narrow circumstances encompassed by interstate exchanges. See *Computer and Communications Industry Association v. FCC, supra*, and *North Carolina Utilities Commission v. FCC*, 552 F.2d 1036, 1046 (4th Cir. 1976), *cert. denied*, 434 U.S. 874 (1977) (hereinafter cited as *NCUC II*).

the people of the United States a rapid, efficient, Nationwide, world-wide wire and radio communication service with adequate facilities at reasonable charges . . . ." 47 U.S.C. 151. State depreciation rate prescriptions that do not adequately provide for capital recovery in the competitive environment, which constitutes this Commission's policy in those markets found capable of supporting competition, would frustrate the accomplishment of that policy and are preemptable by this Commission.

34. Over the past decade the Commission has embarked in several areas of telecommunications to pursue a policy of encouraging competition wherever the market conditions will support such a policy and produce benefits to the public interest. In *MTS-WATS Market Structure Inquiry,* 81 FCC 2d 177 (1980), the Commission opened the domestic MTS-WATS market to competitive entry, reserving the question of entry to Alaska to a later phase since concluded with the adoption of a similar open entry policy, *MTS-WATS Market Structure Inquiry,* FCC 82-515 (released November 30, 1982). In *Computer Inquiry II,* 77 FCC 2d 384 (1980), *recon.,* 84 FCC 2d 50 (1980), *recon.,* 88 FCC 2d 512, *aff'd sub nom., Computer and Communications Industry Association v. FCC, supra,* the Commission opened the areas of enhanced services and customer premises equipment to competitive provision. These are just two examples of the policies which the Commission has pursued. However, they do point up the fact that if this policy is to be successful, it will be necessary for the marketplace to operate efficiently. Such efficient operation requires proper price signals generating from supply and demand conditions.

35. Capital recovery is an important determinant of the price at which services can be offered and significantly affects the amount of facilities provided to supply the

needs of the communications industry. In *Amendment to Part 31,* 83 FCC 2d 267 (1980), *recon.,* 87 FCC 2d 916 (1981), the Commission adopted remaining life and straight line equal life group depreciation methods that recover capital on a basis that approximates straight line unit depreciation more closely than did the previously used methods. More timely capital recovery was anticipated to result in faster technological innovation with its accompanying benefits of more efficient service provision and lower costs resulting from more productive use of facilities.

36. Capital recovery issues are important in the implementation of *Computer Inquiry II* due to the part depreciation plays in the determination of net book value and the resultant gain or loss that may occur on the transfer of assets to the new subsidiary. It will also be significant in any later transfer of assets from the provision of regulated service to unregulated service or vice-versa. Thus, appropriate capital recovery will ease the regulatory burdens associated with supervising the transition to the new structure.

37. Depreciation is a significant portion of the revenue requirement of the regulated telephone companies. As such, it plays an important role in determining the price at which they offer their services. If competition is to be viable, it is necessary for prices to reflect depreciation expenses that are realistic for a competitive market. Absent such depreciation levels, improper signals will be given to the market. Since most plant is used interchangeably to provide interstate and intrastate communications service, supply and demand is determined by the combination of inputs from service demand in both regulatory jurisdictions. Approximately 75 percent of exchange plant is allocated to the intrastate jurisdiction. It is clear that unless telephone plant, including that portion subject to allocation to the intrastate jurisdiction, is

depreciated at a reasonable rate, improperly timed capital recovery will occur. Indeed, in an increasingly competitive environment, it is possible that improper capital recovery could delay or prevent modernization which would add to the costs borne by ratepayers and could, ultimately, threaten carriers' ability to fully recover their invested capital. Moreover, the extent of state action attempting to prevent carriers from utilizing our depreciation prescriptions places substantial burdens on carriers and could well impair their ability to raise the investment capital they will need to fully compete in the continually evolving competitive telecommunications marketplace.[14] Such a result could undermine the achievement of the Commission's objective to develop policies that will engender a dynamic, efficient telecommunications marketplace with services being provided at reasonable prices.

38. NARUC contends that preemption with respect to station connections is unnecessary and will not produce competitive benefits because expensing is not the same as unbundling. While NARUC is correct in a strict sense, it avoids the critical issue, which is the proper timing of cost recovery. If the Commission preempts with respect to station connections and all states must expense these costs, current ratepayers will be paying these costs instead of future ratepayers as would be the case with capitalization. Thus, future prices will reflect the appropriate costs for providing those services. Moreover, if these costs are expensed and state commissions must allow rates to cover these costs, it is likely that the cost causative ratepayer will in many cases be charged for the costs being expensed in connection with the provision of inside wiring. Thus, the Commission's objective may be substantially achieved by preempting state commissions from departing from our expensing rules.

[14] AT&T and GTE indicate several state commissions have refused to follow, have indicated an intent not to follow, or are being urged not to follow Commission determinations with respect to the expensing of inside wiring and/or the adoption of straight-line equal life group or remaining life depreciation methods. A staff review of state action in conjunction with AT&T intrastate tariff proceedings reveals that all but two states have approved expensing of station connections, that 13 states have rejected and 12 have approved equal life group depreciation, and that 9 states have rejected and 22 have approved remaining life group depreciation. Prior to issuing our *Order* in this docket we did not expect that such significant variance would be required by states.

39. In 1971 Congress amended the Communications Act to change the procedures for allocating costs between federal and state jurisdictions by adding Section 410(c). The Commission was given the ultimate authority with respect to such allocations, further solidifying its superintendency over common carrier communications. See *NCUC I, supra* at 795. Section 410(c) procedures provide for uniformity in the separations process, thereby insuring that plant, expenses and revenues will be rationally accounted for in the dual jurisdictional environment. The utilization of one depreciation rate is the most effective method for insuring that this uniformity will be maintained and to insure that no jurisdiction bears a greater burden than another in the transition to a fully competitive marketplace. Several parties suggest that under or over recovery will result from one jurisdiction or another because of the shifting usage patterns for telephone plant over time and argue that if such a result were to occur, significant inequities would result to both ratepayers and carriers. A uniform depreciation rate for each class of property applicable to all property whether allocated to the federal or state jurisdiction clearly eliminates these potential problems.

40. For all of these reasons, it is apparent to us that a substantial impact on federal policies could result if state commissions were allowed to diverge from Commission prescribed depreciation rates and practices. Accordingly,

it is essential to preempt inconsistent state depreciation practices to avoid frustration of these vital national policies.

III. *Declaratory Ruling Petition.*

41. GTE of Ohio seeks to have the Commission preempt an order of the Ohio Public Utilities Commission that did not approve remaining life and equal life group rates for intrastate ratemaking purposes. As alleged by GTE of Ohio, the differential in rates amounts to seven million dollars per year. GTE of Ohio states that failure of this Commission to preempt the state will frustrate the achievement of federal policies adopted by this Commission. Its argument is similar to those cited in connection with the reconsideration petition.

42. Essentially the same arguments are made against the GTE of Ohio petition as were urged on reconsideration with regard to the substance of the issue. However, Ohio cites an Ohio statute that precludes the state commission from adopting remaining life depreciation for intrastate purposes.

43. One procedural argument is raised by Ohio with respect to the petition. It contends that the question presented is premature since the order is subject to further reconsideration before the Ohio Commission pursuant to a request filed by GTE of Ohio. We do not agree since the purpose of declaratory rulings is to give guidance to affected persons in areas where uncertainty or confusion exists. A case or controversy in the judicial sense is not required, *NCUC I, supra* at 790-1. In this case, it appears necessary to issue such a ruling to clarify for the state commissions and the carriers the effect of our depreciation prescriptions. The fact that reconsideration proceedings are under way in Ohio does not mitigate against such a course in light of the divergencies from this Commission's depreciation methods and rates that are occurring to the detriment of federal policies. Thus, we find it imperative

to declare today that inconsistent state prescribed depreciation rates are preempted by the Communications Act and are accordingly void. The existence of a state statute preventing a state commission from adopting a particular method does not affect this determination. When federal preemption is involved, there is no difference between a statute or a regulation of a state commission. Both must fall in the face of overriding federal concerns and policies.

IV. *Conclusion*

44. We have carefully reviewed the record upon reconsideration. The issues raised concerning the *Preemption Order* caused us to reevaluate the statutory language of Section 220(b), the legislative history of the provision, and the relevant judicial and administrative proceedings relating to the subject. Our considered judgment after this review is that the *Preemption Order* must be reconsidered. We find that the most logical and reasonable interpretation of Section 220(b) of the Act is that where the Commission prescribes depreciation rates for classes of property, state commissions are precluded from departing from those rates. Since the depreciation method utilized is a material part in determining the rate to be applied, state commissions are also precluded from departing from the depreciation methods prescribed by the Commission. Thus, the *Expensing Order* is binding upon state commissions and they must expense additions to inside wiring in accordance with the plan established therein. Moreover, they must follow the amortization procedures adopted in that decision for the embedded inside wiring and any additions to the capitalized amount as a result of the phase-in of the expensing of inside wiring.

45. Even if Section 220(b) does not preempt state commissions, we would act under our authority to preempt state actions that interfere with the accomplishment of federal policies and objectives. *Computer and Communications Industry Association v. FCC, supra,* and *NCUC II.*

We note that petitioner and the parties supporting the petition cite several states that have indicated they do not intend to follow the Commission's depreciation prescriptions or expensing of inside wiring, or have refused to follow either. In light of the concerns expressed about an efficiently functioning market, we must find that inconsistent depreciation rates prescribed by state commissions will interfere with the efficient operation of the communications marketplace and thereby frustrate the achievement of the Commission's policies. Accordingly, we find that this Commission's depreciation policies and rates, including the expensing of inside wiring, preempt inconsistent state depreciation policies and rates.

46. Accordingly, IT IS ORDERED, pursuant to Sections 1, 4(i), and 220(b) of the Communications Act of 1934, as amended, 47 U.S.C. 151, 154(i), and 220(b), That the Petition for Reconsideration filed by the American Telephone and Telegraph Company IS GRANTED.

47. IT IS FURTHER ORDERED, That the Petition for Declaratory Ruling filed by General Telephone Company of Ohio IS GRANTED to the extent reflected herein.

48. IT IS FURTHER ORDERED, That the Secretary shall cause this order to be published in the Federal Register.

49. IT IS FURTHER ORDERED, That the Secretary shall cause a copy of this order to be served on each state commission.

FEDERAL
COMMUNICATIONS
COMMISSION*

William J. Tricarico
Secretary

See attached separate statement of Commissioner Joseph R. Fogarty.

Appendix A. Summary of Comments

1. AT&T argues that the Commission on reconsideration should find that state commissions are precluded from departing from the depreciation methods and rates established by this Commission in order to allow the carriers to achieve timely capital recovery. It views the *Preemption Order* as a retreat from the Commission's competitive policies.

2. AT&T asserts that realistic depreciation rates are essential to attain accurate cost-based pricing decisions to prevent artificial barriers to competition, to foster technological innovation which will enhance network efficiency and the availability of competitive alternatives, to facilitate the timely implementation of the detariffing of customer premises equipment[1] and to insure the financial viability of the carriers. It contends that competitive conditions result in faster obsolescence and shorter asset lives, requiring that depreciation methods and rates be inseparable from ratemaking to insure capital recovery.

3. AT&T proposed two legal theories for preempting state commission action. First, it asserts that the Commission may preempt under Sections 1 and 2 of the Act, citing *California v. FCC,* 567 F.2d 84, 86 (D.C. Cir. 1977), *cert. denied,* 434 U.S. 1010 (1978), *NCUC II, NCUC I,* and *NARUC v. FCC,* 533 F.2d 601 (D.C. Cir. 1976). It states that because of the central role depreciation, including the depreciation aspects of station connections, plays in the achievement of the Commission's policies, preemption is necessary to avoid interference with or frustration of these policies.

[1]It contends that different depreciation rates between jurisdictions will result in disagreements about net book value in deregulating CPE and that the application of the Separations Manual will create uncertainty as to which plant a particular book value relates.

4. AT&T's second theory is that Section 220(b) preempts states on its face, asserting that in its earlier pleadings it did not rely on Section 220(g) as suggested by the Commission's decision. It argues that Section 220 gives the Commission discretion with respect to accounting rules, but does not give it much discretion with regard to depreciation prescriptions. AT&T states that the Commission's rule allowing carriers to subdivide an account to comply with a state commission order does not mean that a state can require capitalization when this Commission requires expensing. Finally, it submits that the Commission misread the legislative history of the Communications Act by failing to consider statements in the committee reports and remarks of members at committee hearings that indicate Congress believed the Interstate Commerce Act provisions from which Section 220(b) was taken did in fact preempt the states. See also *Depreciation Charges of Telephone Companies,* 118 I.C.C. 295 (1926).

5. GTE asserts that the Commission's policies in the areas of competition and faster capital recovery will be frustrated if the state commissions are allowed to depart from the depreciation rates and methods prescribed by the Commission. It contends that Section 220(b) preempts the states and distinguishes Section 220(a) as being discretionary on the Commission and argues that the Commission focused only on the provisions of Section 220(a) in its earlier decision. It submits that there is no doubt that a state can require a carrier to keep additional records and memoranda. However, GTE argues that the Commission's decision is overly broad. It is clear, GTE contends, that the Commission can preempt inconsistent state action when it conflicts with national telecommunications policies, and it should do so in this case. GTE also argues that the legislative history and the rules of statutory construction indicate that Congress intended to preempt the states in the

area of depreciation, submitting that property cannot be successfully depreciated at two different rates prescribed by different regulatory bodies because under or over recovery from one or the other jurisdiction will occur from the use of shifting usage factors.

6. The oppositions generally argue that the states have the jurisdiction to determine the extent to which intrastate rates reflect depreciation and expensing adjustments promulgated by the Commission. Sections 2(b) and 221(b) are cited as reserving jurisdiction over local and intrastate telephone rates to the states as intended by Congress when it distinguished between "interstate" and "intrastate" in Sections 1 and 2. Ohio argues that the preemption argument was rejected in the only case of which it is aware, *Pacific Telephone and Telegraph Company v. California,* 401 P. 2d 353 (1965).

7. Ohio asserts that the courts have distinguished between ratemaking and interconnection policies, *NCUC II* and *NCUC I,* and submits that it is the ratemaking jurisdiction reserved to the states that is in question in this proceeding. To permit the Commission to prescribe depreciation rates applicable to all property whether used for interstate or intrastate services would, in Ohio's view, be equivalent to giving the FCC a hand in setting state rates.

8. Ohio is concerned that under some methods, such as remaining life, costs will not be charged to consumers who receive the benefits of the property being depreciated. Finally, it contends that Sections 220(i) and (j) are consistent with concurrent jurisdiction.

9. Ohio argues that GTE is attempting to have the Commission read Section 2(b) out of the act, and asserts that it is inappropriate to ignore language in a statute, to extend a statute beyond its clear import, or to embrace subjects not specifically enumerated. Section 2(b)(1) is stated

by Ohio to have been intended to reverse the Supreme Court decision in *Houston East and West Texas Ry. v. U.S.*, 234 U.S. 342 (1914), wherein the ICC was given the power to suspend intrastate rates enabling carriers to raise intrastate rates to federal levels for similar distances. NARUC and Ohio argue that Section 2(b) was intended to ensure that state jurisdiction was not limited by the 1934 legislation.

10. Several parties assert that there is considerable Commission precedent recognizing the states' independent ratemaking authority, including departures from Commission prescribed accounting, for intrastate rates. They note that the Commission has encouraged state commissions to devote more resources to depreciation matters, *Amendment of Part 31,* 83 FCC 2d 267 (1980) *recon.*, 87 FCC 2d 916 (1981), has recognized in this proceeding the state jurisdiction over expensing of station connections for state ratemaking purposes, has recognized divergent treatment of interest during construction and has not contested California's use of remaining life for approximately thirty years. Ohio argues that there is nothing to suggest that there needs to be national uniformity in depreciation procedures and that local diversity is desirable, noting that even a GTE of Ohio witness in an Ohio rate case has indicated that local diversity in setting depreciation rates is preferable.

11. Ohio contends that *McDonnell Douglas Corp. v. General Telephone Company of California,* 594 F.2d 720 (9th Cir. 1979), recognized the validity of intrastate regulatory jurisdiction under the Act by finding that Congress in enacting Section 2(b) had intended to give states considerable power with respect to wire communications that are wholly intrastate in nature.

12. California argues that the Commission's refusal to preempt state power to prescribe depreciation rates for

intrastate ratemaking purposes will not undermine the Commission's procompetitive policies or signal a retreat since many states have adopted policies that foster competition. AT&T's assertion that preemption must be exercised to promote procompetitive policies is rejected by NARUC as unsupported. It states that expensing of station connection costs can have no competitive effect because expensing is not the same as unbundling. Moreover, it contends that the Commission did not adopt remaining life and equal life group depreciation procedures to promote competition but, rather, to more properly time capital recovery and insure that any deficiency in past depreciation was adjusted. Finally, NARUC states that the speculative statements about the numbers of states that are not following the Commission's policies are inadequate to justify preempting state commission jurisdiction on the theory that federal policies are being frustrated.

13. NARUC argues that the attempted distinction of Section 220(a) from Section 220(b) on the basis that Section 220(b) is mandatory while Section 220(a) is discretionary does not address the question of the preemptive effect of either section. It contends that neither reason nor case law provides support for asserting that preemption of state regulation of intrastate communications is automatic with respect to subject areas which the FCC must regulate on the interstate level. It further notes that the language of Section 220(b) does not differ significantly from that in Section 220(g) with respect to the effect of prescribed depreciation rates, accounts or records other than as prescribed by the Commission. NARUC states that the relationship between accounting and ratemaking is self evident and argues that state control over intrastate rates would have little vitality if state com-

missions were deprived of the power to disallow expenses and depreciation claimed by carriers. NARUC asserts that the fact that a proposed Section 220(j) that would have expressly reserved depreciation prescription powers to the states was not adopted does not mean that states must be bound by Commission depreciation prescriptions, stating that the final provision adopted was a compromise.

14. Consumers' Counsel supports the Commission's *Preemption Order* and generally cites from that *Order* in support of its position. Idaho also agrees with the conclusion of the Order and states that it believes that administrative costs of separate record keeping to meet state requirements will be small. Arkansas filed to indicate that its opinions had not rejected the new depreciation methods outright but had left the decision to individual cases for resolution.

15. AT&T's reply submits that the setting of depreciation rates does not constitute the exercise of jurisdiction with respect to charges for intrastate services. It argues that Section 2(b) does not deprive this Commission of jurisdiction over jointly used property where its regulation affects the conduct or development of interstate communications. AT&T states that if a state utilized the depreciation rate prescribed by the Commission, it may make adjustments to the test period data to reflect concepts of used and useful property or other pro forma adjustments to reflect conditions during the period during which the tariff will be in effect.

16. AT&T distinguishes *Houston East and West Texas Ry. Co. v. U.S., supra,* by asserting that that case involved actual preemption of service rates. It notes that while Congress may have sought to reverse that decision in the communications field, the issue here is only the jurisdiction

to prescribe depreciation rates. Thus, it contends that the case actually suggests that Section 2(b) should be narrowly interpreted. Moreover, while use of federally prescribed depreciation rates may significantly affect intrastate rates, the states remain free to price individual service rates. See *e.g., NCUC I.*

17. USITA submits that federal preemption of jurisdiction over depreciation rate prescriptions for carriers for which the Commission has prescribed depreciation rates would not interfere with state commission ability to set intrastate service rates in accordance with any ratemaking method desired. It contends that the setting of depreciation rates is not a ratemaking function pursuant to Sections 201-205, but is the exercise of a specific power granted to the Commission by Congress. USITA argues that divergent depreciation rates create confusion and raise problems of capital recovery.

18. GTE contends that state action whether in the nature of ratemaking or otherwise which "stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress" will be preempted. *Fidelity Federal Savings and Loan Association v. de la Cuesta,* 50 LW 4916, 4919 (1982). GTE concludes that the states do not have the power through the guise of ratemaking to negate FCC action designed to give effect to federal statutory objectives. GTE does not challenge state rights pursuant to state statutes to regulate rates for intrastate services. It asserts that no preclusion of state ratemaking jurisdiction would result from FCC preemption under Section 220(b), although failure to preempt will endanger important national policies.

19. GTE submits that Section 220(b) charges the Commission with the responsibility of prescribing depreciation rates for carriers subject to the Act and recognizes only two exceptions. First, the Commission should act as

soon as possible. Second, Section 220(h) recognizes that certain classes of carriers may be exempted. The Commission, according to GTE, has not exercised its authority pursuant to this provision in this proceeding. Finally, GTE argues that reliance on *NCUC I* and *NCUC II* as supporting a finding that the Commission cannot preempt state commission depreciation prescriptions for carriers subject to the Act is inconsistent with the holdings and analysis of those cases. AT&T and GTE submit that Section 221(b) is inapplicable because that provision was intended only to give states the jurisdiction to regulate local exchange service extending over a state boundary.

Separate Statement of
Commissioner Joseph R. Fogarty

In Re: Reconsideration of Docket No. CC 79-105.

Having dissented from the Commission's original decision declining to preempt State accounting and depreciation rules inconsistent with those prescribed by the FCC,[1] I am pleased that the Commission has reconsidered this issue and acted to preempt such inconsistent State regulation.

As this *Order* establishes in detail, a true reading of the statutory language and legislative history of Section 220(b) of the Communications Act clearly demonstrates that Congress intended FCC depreciation rules and policies to control the field.

Even if preemption were not explicitly mandated by Section 220(b), the effective implementation of our pro-competitive federal telecommunications policies dictates that inconsistent State depreciation regulation be preempted by this Commission. We cannot "defer to the States" on capital recovery issues. Telephone companies must be able to recover their cost of capital in a timely and effective manner if they are to price their services efficiently and to improve and expand their facilities to meet the challenges of competition and technologic innovation.

This preemption imperative is not merely theoretical. Too many States (e.g., Alabama, Louisiana, Nebraska, Ohio, New Jersey, Michigan, Arkansas) have already refused to recognize the critical necessity of the FCC's cost recovery principles. The resulting depreciation rate differentials are alarming: GTE of Ohio has indicated that it

[1]Amendment of Part 31, Joint Dissenting Statement of Commissioners Joseph R. Fogarty and Anne P. Jones, 89 FCC 2d 1109-1111 (1981).

will be denied $7 million in capital recovery this year if the State of Ohio's disparate depreciation treatment is allowed to prevail.

The FCC cannot ignore the detrimental impacts of inconsistent State treatment of depreciation if our pro-competitive policies are to have any integrity and viability. This Commission now recognizes that preemption is both mandated as a matter of law and essential as a matter of policy, and our action today has my full endorsement and support.

Appendix B

Communications Act of 1934, as amended

47 U.S.C. § 151

Sec. 1. For the purpose of regulating interstate and foreign commerce in communication by wire and radio so as to make available, so far as possible, to all the people of the United States a rapid, efficient, Nation-wide, and world-wide wire and radio communication service with adequate facilities at reasonable charges, for the purpose of the national defense, for the purpose of promoting safety of life and property through the use of wire and radio communication,[1] and for the purpose of securing a more effective execution of this policy by centralizing authority heretofore granted by law to several agencies and by granting additional authority with respect to interstate and foreign commerce in wire and radio communication, there is hereby created a commission to be known as the "Federal Communications Commission," which shall be constituted as hereinafter provided, and which shall execute and enforce the provisions of this Act.

47 U.S.C. § 152

Sec. 2. (a) The provisions of this Act shall apply to all interstate and foreign communication by wire or radio and all interstate and foreign transmission of energy by radio, which originates and/or is received within the United States, and to all persons engaged within the United States in such communication or such transmission of energy by radio, and to the licensing and regulating of all radio stations as hereinafter provided; but it shall not apply to persons engaged in wire or radio communication or transmission in the Canal Zone, or to wire or radio

[1]The provisions relating to the promotion of safety of life and property was added by "An Act to amend the Communications Act of 1934, etc." Public No. 97, 75th Congress, approved and effective May 20, 1937, 50 Stat. 189.

communication or transmission wholly within the Canal Zone.[2]

(b)[3] Except as provided in section 224 and subject to the provisions of section 301, nothing in this Act shall be construed to apply or to give the Commission jurisdiction with respect to (1) charges, classifications, practices, services, facilities, or regulations for or in connection with intrastate communication service by wire or radio of any carrier, or (2) any carrier engaged in interstate or foreign communication solely through physical connection with the facilities of another carrier not directly or indirectly controlling or controlled by, or under direct or indirect common control with such carrier, or (3) any carrier engaged in interstate or foreign communication solely through connection by radio, or by wire and radio, with facilities, located in an adjoining State or in Canada or Mexico (where they adjoin the State in which the carrier

[2]The words "the Philippine Islands or" preceding "the Canal Zone" are omitted on authority of Proc. No. 2695, effective July 4, 1946, 11 Fed. Reg. 7517, 60 Stat. 1352, recognizing the independence of the Philippine Islands.

[3]Subsection 2(b) was amended by adding the words, "Except as provided in section 224 and" at the beginning of the subsection by section 5, Public Law 95-234, approved February 21, 1978, 92 Stat. 33. The subsection was previously amended to read as above by Public Law 345, 83d Congress, 2d Session, approved April 27, 1954, 68 Stat. 63. This subsection formerly read as follows:

(b) Subject to the provisions of section 301, nothing in this Act shall be construed to apply or to give the Commission jurisdiction with respect to (1) charges, classifications, practices, services, facilities, or regulations for or in connection with intrastate communication service of any carrier, or (2) any carrier engaged in interstate or foreign communications solely through physical connection with the facilities of another carrier not directly or indirectly controlling or controlled by, or under direct or indirect common control with such carrier; except that sections 201 to 205 of this Act, both inclusive, shall, except as otherwise provided therein, apply to carriers described in clause (2).

is doing business), of another carrier not directly or indirectly controlling or controlled by, or under direct or indirect control with such carrier, or (4) any carrier to which clause (2) or clause (3) would be applicable except for furnishing interstate mobile radio communication service or radio communication service to mobile stations on land vehicles in Canada or Mexico; except that sections 201 through 205 of this Act, both inclusive, shall, except as otherwise provided therein, apply to carriers described in clauses (2), (3), and (4).

47 U.S.C. § 221

(b) Subject to the provisions of section 301 of this title, nothing in this chapter shall be construed to apply, or to give the Commission jurisdiction, with respect to charges, classifications, practices, services, facilities, or regulations for or in connection with wire, mobile, or point-to-point radio telephone exchange service, or any combination thereof, even though a portion of such exchange service constitutes interstate or foreign communication, in any case where such matters are subject to regulation by a State commission or by local governmental authority.

(1) (4) (3) (2)

Nos. 84-871, 84-889, 84-1054 and 84-1069

IN THE

Supreme Court of the United States

OCTOBER TERM, 1984

LOUISIANA PUBLIC SERVICE COMMISSION,
Appellant,

v.

FEDERAL COMMUNICATIONS COMMISSION and
UNITED STATES OF AMERICA, et al.,
Appellees.

(and three related cases)

On Appeal from and Petitions for a Writ of Certiorari to the United States Court of Appeals for the Fourth Circuit

CONSOLIDATED MOTION TO DISMISS OR AFFIRM AND BRIEF IN OPPOSITION TO PETITIONS FOR CERTIORARI

DONALD MCG. ROSE*
DAVID HORN
2500 Central Trust Center
201 East Fifth Street
Cincinnati, OH 45202
513-651-6944

Attorneys for Cincinnati Bell Telephone Company

JOHN WOHLSTETTER*
1800 K Street, N.W.
Washington, D.C. 20006
202-466-2895

Attorney for Continental Telecom, Inc.

MICHAEL BOUDIN*
DAVID H. REMES
ELIZABETH V. FOOTE
1201 Pennyslvania Ave., N.W.
P.O. Box 7566
Washington, D.C. 20044
202-662-6000

Attorneys for AT&T and the Bell Operating Companies (other than Cincinnati Bell, Nevada Bell, and Pacific Bell)

[List of Counsel Continued on Inside Cover]

33 PP

CAROLYN C. HILL*
JAMES T. ROCHE
1875 Eye Street, N.W.
Washington, D.C. 20006
202-659-4600

MARIA KENDRO
P.O. Box 11315
Kansas City, MO 64112
913-676-3000

Attorneys for United Telephone Systems, Inc.

March 1985

JUDITH A. MAYNES
W. PRESTON GRANBERY
295 North Maple Avenue
Basking Ridge, NJ 07920
201-221-2004

Attorneys for AT&T

ALBERT H. KRAMER*
2000 M Street, N.W.
Washington, D.C. 20036
202-223-6611

Attorney for North American Telecommunications Association

**Counsel of Record*

QUESTION PRESENTED*

Section 220 of the Communications Act, 47 U.S.C. § 220, provides that the Federal Communications Commission "shall" determine depreciation for telephone company plant of carriers subject to the Act; it invites the states to give their views and recommendations to the FCC; and it forbids the carriers from using any depreciation rate, or depreciating any plant, except as permitted by the FCC. The question presented is:

Whether the FCC acted within the scope of its authority and rationally exercised its expert judgment in determining that telephone plant used interchangeably for interstate and intrastate communication must be depreciated according to the FCC's rules and orders and that state commissions cannot require the companies to use inconsistent rates and methods to depreciate the same plant.**

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* The listing required by S. Ct. Rule 28.1 appears in the appendix to this document. See p. 2a, below.

** Answering this question in the affirmative, the Court of Appeals sustained the FCC without reaching an independent, alternative ground for preemption, namely, automatic statutory preemption under Section 220. See p. 6, n.11, below. In the event that this Court grants plenary review, appellee respondents reserve the right to defend the FCC on each of the alternative grounds.

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TABLE OF AUTHORITIES

IN THE

Supreme Court of the United States

OCTOBER TERM, 1984

Nos. 84-871, 84-889, 84-1054 and 84-1069

LOUISIANA PUBLIC SERVICE COMMISSION,
Appellant,

v.

FEDERAL COMMUNICATIONS COMMISSION and
UNITED STATES OF AMERICA, et al.,
Appellees.

(and three related cases)

On Appeal from and Petitions for a Writ of Certiorari to the United States Court of Appeals for the Fourth Circuit

CONSOLIDATED MOTION TO DISMISS OR AFFIRM AND BRIEF IN OPPOSITION TO PETITIONS FOR CERTIORARI

This consolidated motion to dismiss or affirm and brief in opposition is filed on behalf of 26 parties who supported the Federal Communications Commission in the court below.[1] It demonstrates that no appeal lies in this case and that certiorari is not warranted.

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[1] The names of the subscribing parties are set forth in the appendix to this document. See p. 1a, below.

STATEMENT OF FACTS

In 1980 and 1981, the Federal Communications Commission made substantive changes in its technical rules for determining depreciation of telephone plant in the United States. Thereafter, the FCC ruled in 1983 that it would frustrate federal policy for individual states to order telephone companies to depreciate the same telephone plant using depreciation rates or methods inconsistent with those adopted by the FCC. The Fourth Circuit upheld the 1983 preemptive decision as rational and within the FCC's statutory authority under decisions of this Court and a uniform line of cases in the courts of appeals.

A. The Statutory Plan and the FCC's Depreciation Rules

Local telephone plant in the United States is used jointly for interstate and intrastate communication. Whether a call travels across the street or across the United States, it originates in the same telephone set or switchboard, uses the same "inside wiring" in the home or office, and traverses the same cable to the switching facilities at the telephone company central office. From the standpoint of physical facilities, the United States has long had "a unified system of communication." [2]

This joint use of telephone plant was recognized by Congress from the outset. Section 220(b) of the Communications Act of 1934 ("the Act"), 47 U.S.C. § 220(b), provides that the FCC "shall" prescribe depreciation for carriers subject to the Act. Depreciation measures the loss of service value of a capital asset over time by allocating the asset's cost, through an annual depreciation expense, to the individual years in which the asset is usefully in service. That depreciation expense is reflected in rates for the services provided by the carrier and, because local telephone plant is used for both interstate and intrastate services, the depreciation expense

[2] *General Telephone Company of California* v. *FCC*, 413 F.2d 390, 401 (D.C. Cir.) (Burger, J.), *cert. denied*, 396 U.S. 888 (1969).

affects both interstate and intrastate rates for telephone service.[3] However, depreciation does not itself determine those rates, which reflect many other elements. See pp. 15-16, below.

Recognizing the dual impact of depreciation, Section 220 reserves to the FCC the ultimate decision on depreciation of jointly used telephone plant of carriers subject to the Act. Section 220(b) explicitly forbids such carriers from depreciating any property, or using any rate of depreciation, other than as permitted by the FCC. Congress took account of the impact of Section 220 on the states by requiring the FCC to consider the "views and recommendations" of the states before adopting or altering accounting requirements including depreciation. Section 220(i), 47 U.S.C. § 220(i). In enacting Section 220, Congress deliberately rejected a proposed amendment to that section, urged by the states, that would have granted the states a right to ignore FCC depreciation decisions and set separate depreciation rates for use in intrastate ratemaking. See pp. 12-13, below.

Consistent with this explicit mandate, the FCC has for almost 50 years maintained rules governing depreciation of telephone plant.[4] In addition, for the major carriers owning the bulk of telephone plant in the United States, the FCC has prescribed specific depreciation rates for classes of property owned by such companies. In adopting depreciation rules and prescribing specific rates, the FCC has consulted with state commissions and considered their views, but the rules and

[3] For example, if a line connecting a house with the cable to the local exchange cost $100 and was expected to last 10 years, one common method of depreciation would assign $10 a year as an expense to be recovered through rates for telephone service over 10 years. For jointly used plant, the FCC also has paramount authority to "separate" the expense between the interstate and intrastate rates. See Sections 221(c) and 410(c) of the Act, 47 U.S.C. §§ 221(c), 410(c). Thus, depending on the separations formula adopted by the FCC, part of the $10 per year would be reflected in interstate rates and the balance in intrastate rates.

[4] Since the 1930s, the FCC has prescribed and revised a Uniform System of Accounts for telephone companies, including rules determining the categories of plant that may be depreciated (*e.g.*, 47 C.F.R. § 31.02-82) and rules determining methods of depreciation. *Id.* § 31.02-80.

orders have been those of the FCC itself.[5] For many years, state commissions tended voluntarily to respect those FCC rules and orders.

Complex questions of engineering, accounting and regulatory judgment are involved in establishing depreciation for literally millions of diverse pieces of telephone plant constantly undergoing replacement in the United States. Various methods exist for allocating depreciation to different years, estimating the useful life of plant, appraising salvage value, correcting misestimates of useful life, and grouping related items of plant. In a period of rapid technological innovation, the FCC has made a continuing effort to improve depreciation rules so that the resulting regime is workable, consistent and accurate.

After several years of study, the FCC in 1980 and 1981 revised certain of the depreciation rules.[6] First, in 1980, it ruled that telephone companies would be allowed to use two methods, called equal life group and remaining life, in computing depreciation of telephone plant and in revising estimates of depreciation that proved to require correction.[7] Second, in 1981, the FCC ruled that a particular class of plant—a portion of inside wiring—should be "expensed" when actually installed rather than depreciated over a period of years.[8]

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[5] *E.g., In re Prescription of Revised Percentages of Depreciation for AT&T*, 88 F.C.C.2d 1223 (1982), containing depreciation tables for over 20 telephone companies.

[6] *In re Amendment of Part 31*, 83 F.C.C.2d 267 (1980), *reconsideration denied*, 87 F.C.C.2d 916 (1981); *In re Amendment of Part 31*, 85 F.C.C.2d 818 (1981).

[7] Equal life group is a method of depreciating, on a group basis, subclasses of telephone plant (*e.g.*, telephone poles) whose individual units are forecasted to have the same useful lives. Remaining life is a method of adjusting depreciation, where original estimates of useful life have proved to be mistaken, so that at the end of the useful life the depreciation will add up to 100% of the investment (less salvage value), avoiding under- or over-recovery.

[8] Section 220 empowers the FCC to decide which categories of plant should be depreciated as capital assets and which should instead be "expensed" in a single year. For the inside wiring involved, the FCC found that such expensing would place the cost burden on the class of users that caused those costs to be incurred.

In the proceedings that led to these changes in the depreciation rules, many parties participated, including a number of state commissions. The FCC extensively analyzed the need for the new rules and provided for specific options and phase-in periods to ease the transition. When the new rules were promulgated, neither the states nor any other parties sought judicial review within the statutory period. The rules therefore became final and are no longer subject to judicial review. 28 U.S.C. § 2344.

B. The FCC's Preemption Decision and Judicial Proceedings

Following the changes in depreciation rules in 1980 and 1981, the National Association of State Regulatory Utility Commissioners ("NARUC") and the California Public Utilities Commission asked the FCC to hold that the new rules were not binding on the states. In a decision released in 1982, the FCC affirmed that it had authority to preempt state measures that "frustrate [federal] policies or rules" but by a four-to-three vote the FCC found no present need to exercise that authority.[9] As the FCC later explained, it had assumed in refusing to preempt that the state commissions would continue their ordinary practice of following FCC depreciation rulings.[10]

AT&T and GTE sought reconsideration of the FCC's 1982 decision. They pointed out that states were now deviating from the new depreciation rules, thwarting the FCC's depreciation policies. On reconsideration in early 1983, the FCC held unanimously that its new depreciation rules on equal life group, remaining life and inside wiring had to be followed in state proceedings. 1983 Decision (A-24). It found that its new rules were being disregarded in a number of states and that the objectives that the FCC sought to achieve through the rules

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[9] *In re Amendment of Part 31*, 89 F.C.C.2d 1094, 1108 (1982), reprinted at Louisiana Appendix A-61 (references hereafter to "A- " are to that appendix). The decision also found that Section 220 did not compel the FCC to preempt.

[10] *In re Amendment of Part 31*, 92 F.C.C.2d 864, 866-67 (1983) (A-27 to A-28) (cited hereafter as "1983 Decision").

would be frustrated by inconsistent state action. *Id.* ¶ 37 & n.14 (A-46).[11]

The FCC emphasized that the plant in question is used interchangeably for interstate and intrastate communication. 1983 Decision ¶ 37 (A-45). It explained how accurately timed capital recovery, which its new depreciation rules assist, directly promotes the modernizing of telephone plant and ultimately permits more efficient service at lower cost for the public. *Id.* ¶ 33 (A-43). It described how the states' use of inconsistent depreciation methods for the same plant threatened these federal policies and impaired the FCC's ability to assure a proper allocation of joint costs between interstate and intrastate service. *Id.* ¶ 39 (A-47). It specifically found that preemption was "essential" in order to avoid "frustration of these vital national policies." *Id.* ¶ 40 (A-47).[12]

The Virginia State Corporation Commission sought judicial review of the 1983 preemption decision in the Fourth Circuit, and a number of other state commissions intervened to support review. The FCC, the United States, and a number of other parties defended the decision. In the Court of Appeals, the state commissions did not challenge the FCC's decision that equal life group and remaining life and the expensing of inside wiring served the public interest. Principally, they argued that the FCC had no power to make its depreciation rules binding, contending that the Act reserved to the states the right to use different depreciation rates for the same telephone plant in state proceedings.

In June 1984, the Court of Appeals affirmed the FCC's 1983 preemption decision.[13] It held that the FCC had explicit

[11] In the alternative, the FCC found, based on reexamination of statutory language and legislative history, that preemption could be premised on the automatic operation of Section 220 without requiring a specific FCC finding of need. However, in light of the FCC's supported finding of need in this case, the Fourth Circuit found it unnecessary to reach the alternative ground of automatic preemption in order to sustain the FCC's action.

[12] The FCC did not preempt the states in determining the ultimate rates to be charged to customers for intrastate services. Its decision was limited solely to depreciation. *Id.* ¶¶ 44-45 (A-49 to A-50).

[13] *Virginia State Corporation Comm'n* v. *FCC*, 737 F.2d 388 (4th Cir. 1984) (A-1).

statutory authority under Section 220 to determine depreciation for telephone plant used jointly for interstate and intrastate service. Under preemption principles well established in this Court, the Fourth Circuit ruled that the FCC could exercise preemptive authority under the Act to exclude inconsistent state regulation where, as here, the statute does not bar such preemption.[14] Finally, the lower court found, on the facts of this case, that the FCC had rationally justified its preemptive action.

The Fourth Circuit rejected claims that the FCC's preemptive action invaded authority reserved to the states under the Act. The court noted that the same construction of the Act being urged by the state commissions had been uniformly rejected by the circuit courts including two prior decisions of the Fourth Circuit, followed by denials of certiorari in this Court,[15] and prior decisions of the First, Second and District of Columbia Circuits.[16] The Fourth Circuit denied rehearing and rehearing *en banc* in October 1984 without further opinion.[17]

The FCC's 1983 preemption decision has now been in effect for almost two years and the majority of states have respected the FCC's new depreciation rulings. In a limited

[14] The Fourth Circuit relied directly on *Fidelity Federal Savings & Loan Ass'n* v. *de la Cuesta*, 458 U.S. 141 (1982), where this Court reaffirmed that preemption could be based on an exercise of federal-agency authority under a statute that left states free to act in the absence of agency preemption.

[15] *North Carolina Utilities Comm'n* v. *FCC*, 552 F.2d 1036 (4th Cir.), *cert. denied*, 434 U.S. 874 (1977) ("*NCUC II*"); *North Carolina Utilities Comm'n* v. *FCC*, 537 F.2d 787 (4th Cir.), *cert. denied*, 429 U.S. 1027 (1976) ("*NCUC I*").

[16] *Computer and Communications Industry Ass'n* v. *FCC*, 693 F.2d 198 (D.C. Cir. 1982), *cert. denied*, 461 U.S. 938 (1983) ("*Computer II*"); *Puerto Rico Telephone Co.* v. *FCC*, 553 F.2d 694 (1st Cir. 1977); *New York Telephone Co.* v. *FCC*, 631 F.2d 1059 (2d Cir. 1980); *People of State of California* v. *FCC*, 567 F.2d 84 (D.C. Cir. 1977), *cert. denied*, 434 U.S. 1010 (1978).

[17] One judge, who had earlier dissented in both *NCUC I* and *NCUC II*, dissented from both the panel decision and the denial of rehearing *en banc*. In none of the three cases has any other judge agreed with the dissent's position.

number of cases, state commissions have sought to disregard the depreciation rulings, resulting in federal district court actions to enforce the FCC's depreciation rules. See pp. 18-19, below. However, no enforcement issues were before the Fourth Circuit in the present case; the decision below addressed itself solely to the validity of the FCC's 1983 preemption decision under Section 220 and doctrines governing preemption.

The Louisiana Public Service Commission has now docketed a purported appeal in this Court to challenge the Fourth Circuit decision (No. 84-871). Certiorari petitions to review the same decision have been filed by the California Public Utilities Commission and a number of other state commissions (No. 84-889), by the Ohio Public Utilities Commission (No. 84-1054), and by the Florida Public Service Commission (No. 84-1069). The gist of the state commission claims in all of the documents, echoing claims made and previously rejected in four courts of appeals, is that the FCC lacked authority to preempt inconsistent state action.

ARGUMENT

The "appeal" filed by Louisiana is outside this Court's appellate jurisdiction and should be dismissed on that ground. Appeals under 28 U.S.C. § 1254(2) lie only where an individual state statute is "expressly struck down" on constitutional or related grounds,[18] and the Fourth Circuit decision has not "expressly struck down" any state statute, rule, or order.[19] The sole action taken by the Fourth Circuit was to uphold the validity of the FCC's 1983 preemption decision measured by the Communications Act and the case law governing federal agency preemption. If Louisiana is arguing that state measures were undercut by implication, that is exactly the class of cases

[18] *Silkwood* v. *Kerr-McGee Corp.*, 104 S. Ct. 615, 620-21 (1984), citing numerous cases and affirming the policy that statutes authorizing appeals to this Court "are to be strictly construed."

[19] Although Louisiana refers to several Louisiana orders as if the Court of Appeals had invalidated them (J.S. 2), no reference to them appears in the Fourth Circuit decision, and they were not discussed in the briefs filed in the Fourth Circuit.

that *Silkwood* held "do not" come within the scope of the appeal statute. 104 S. Ct. at 621.

Viewing this case alternatively as one in which certiorari is sought, it should be denied under the accepted standards for review. The Fourth Circuit decision is consistent with preemption doctrine in this Court and the uniform construction of the Communications Act in four circuits. The FCC's power to preempt depreciation is supported by the language of Section 220 and by specific legislative history showing that Congress in 1934 deliberately refused to grant the very authority now claimed by the states. The FCC has amply supported its finding that federal depreciation policies would be frustrated if states utilized inconsistent depreciation rates and methods for the same telephone plant governed by the FCC's own rules.[20]

I. The Decision Below Applies Settled Preemption Doctrine, Accords With the Statute and Its Legislative History, and Rests on Reasoned Findings by the Expert Agency.

1. Local telephone plant, jointly used to carry interstate and intrastate communication, is subject to the FCC's authority under the Act.[21] Section 220(b) applies to such plant and gives the FCC express authority to determine depreciation for it. In this case, the Fourth Circuit affirmed that the FCC, in exercising that statutory authority, could preempt state attempts to depreciate the same telephone plant using inconsistent rates or methods.

Although Section 220 contains language to suggest that it is automatically preemptive, it was unnecessary for the Fourth Circuit (and is unnecessary for this Court) to decide this issue. Under settled doctrine in this Court, a federal agency addressing a subject within the scope of its general statutory authority can preempt inconsistent state regulation where the federal agency rationally finds that this step is necessary to achieve

[20] For these same reasons, summary affirmance would be called for in No. 84-871 if it were treated as a proper appeal.

[21] The Act gives the FCC authority over "interstate communication", and includes within the definition of communication "all instrumentalities, facilities [and] apparatus . . . incidental" to transmission. Sections 2(a), 3(a), 3(b), 47 U.S.C. §§ 152(a), 153(a), 153(b).

federal policy and where such preemption does not violate the statute. Only last Term, in *Capital Cities Cable, Inc.* v. *Crisp,* 104 S. Ct. 2694 (1984), the Court reaffirmed the governing rule:

> "When the administrator promulgates regulations intended to pre-empt state law, the court's inquiry is . . . limited: 'If [h]is choice represents a reasonable accommodation of conflicting policies that were committed to the agency's care by the statute, we should not disturb it unless it appears from the statute or its legislative history that the accommodation is not one that Congress would have sanctioned.' " [22]

This doctrine has been uniformly applied in prior cases in four different circuits (see p. 7, above) to sustain preemptive action by the FCC, including regulation affecting telephone plant jointly used for interstate and intrastate communication. In this case, the Fourth Circuit applied the settled test: it determined that the FCC did possess authority over depreciation of such plant, that the Act did not bar preemption, and that the agency had provided a rational basis for concluding that inconsistent state regulation would frustrate federal policy. In sum, the preemption doctrine applied by the Fourth Circuit is consistent with decisions of this Court and the courts of appeals.

The basis for preemption is even stronger in this instance than in the ordinary case because of the balance struck by Congress between federal and state authority in Section 220 itself. That statute expressly gives the FCC authority to determine the "depreciation which shall be charged"; it provides that the states' role is to furnish their "views and recommendations" to the FCC; and it forbids the carriers from charging depreciation "other than that prescribed therefor by the [Federal Communications] Commission." Sections 220(b), (i). Therefore, the FCC's authority to preempt is solidly

[22] 104 S. Ct. at 2700, quoting *Fidelity Federal Savings & Loan Ass'n* v. *de la Cuesta, supra,* 458 U.S. at 153-54, and *United States* v. *Shimer,* 367 U.S. 374, 383 (1961).

grounded in a statutory plan that contemplates federal superintendence where depreciation is involved.[23]

2. The state commissions argue that even if preemption is otherwise within the FCC's authority, it is barred by Section 2(b)(1) of the Communications Act, 47 U.S.C. § 152(b)(1), which withholds from the FCC jurisdiction over intrastate communication.[24] The dispositive answer is that jointly used plant, whose depreciation is at issue in this case, is subject to the FCC's jurisdiction over interstate communication under Section 2(a) and does not constitute the type of intrastate communication Congress meant to insulate under Section 2(b). A consistent line of decisions in four circuits has reached this conclusion.[25] No circuit has taken the contrary view.[26]

This uniform reading of the Act by the circuit courts is reinforced by decisions of this Court construing the FCC's mandate. This Court has repeatedly stressed the breadth and flexibility of the FCC's authority where interstate communication is involved and has in such cases upheld FCC regulation despite the effect on local activities or regulation.[27] The

[23] Congress followed a similar approach in two other related sections of the Act that also deal with jointly used plant. Sections 221(c) and 410(c) give the FCC final authority to separate costs of jointly used plant between federal and state jurisdictions (see p. 3, n.3, above) after considering a recommendation from a federal-state panel. *NCUC I, supra,* 537 F.2d at 795.

[24] Although the state commissions also refer to Section 221(b) of the Act, 47 U.S.C. § 221(b), legislative history shows that this provision was directed to the narrow problem, not involved in this case, of local exchanges overlapping state lines. See, *e.g., Computer II, supra,* 693 F.2d at 216-17 & n.103, citing legislative history and decisions of three other circuits.

[25] See p. 7, above. Section 2(b) has been uniformly interpreted not to preclude FCC regulation of "facilities that necessarily serve both interstate and intrastate communications" (*NCUC I,* 537 F.2d at 794); rather, the provision is directed to intrastate subjects which are "separable from and do not substantially affect" interstate communication. *Computer II,* 693 F.2d at 215, quoting *NCUC I.* This Court denied certiorari in both cases.

[26] Florida's citation of *NARUC* v. *FCC* 533 F.2d 601 (D.C. Cir. 1976), relies on language rejected by two of the three judges in that case. See *id.* at 621, 634. The D.C. Circuit's definitive view is stated in the subsequent *Computer II* case, which directly relies upon the Fourth Circuit precedents. 693 F.2d at 215-16.

[27] See, *e.g., United States* v. *Southwestern Cable Co.,* 392 U.S. 157 (1968); *Capital Cities Cable, Inc.* v. *Crisp, supra,* 104 S. Ct. 2694.

Chief Justice made the same point 15 years ago in a court of appeals decision, construing the Act in light of this Court's decisions, and concluding that the United States has "a unified system of communication" whose effective regulation would be frustrated in the absence of a "central authority." [28]

The states' reliance on Section 2(b)'s general language is misplaced for yet another reason. Section 220 enacts a detailed regime for the setting of depreciation by the FCC and prescribes a limited advisory role for the states in this regime. When a subject is treated specifically in a statute, that specific treatment normally prevails over any inferences from more general language in the same enactment. Here, the express terms of Section 220 show that Congress gave the FCC final authority over depreciation and did not reserve to the states any right to use inconsistent rates or methods. See p. 10, above.

Congress' intent is confirmed not only by the language of Section 220 but by its legislative history which, with unusual clarity, shows that Congress did not intend to bar the action taken by the FCC in this case. Section 220 derived from a section of the Interstate Commerce Act which had empowered the ICC to set depreciation of telephone company as well as railroad plant. Prior to 1934, the ICC had already read this section as preempting state power if and when the ICC actually prescribed depreciation for telephone companies and railroads.[29] To avoid this result, the state commissions proposed an amendment, when Section 220 was being drafted, to provide that states could as a matter of right prescribe their own telephone-company depreciation requirements for intrastate ratemaking purposes.[30]

[28] *General Telephone Company of California* v. *FCC, supra,* 413 F.2d at 401 (Burger, J.), expressly addressing Section 2(b)(1) and other relevant provisions.

[29] See *Depreciation Charges of Telephone Companies* and *Depreciation Charges of Steam Railroad Companies,* decided together at 118 I.C.C. 295, 328-33 (1926), *further proceedings,* 177 I.C.C. 351 (1931).

[30] As proposed by the House Committee, Section 220(j) would in pertinent part have reserved power to each state "to prescribe, for purposes of the exercise of its jurisdiction with respect to any carrier, the percentage rate of depreciation" for any such carrier's property. See S. 3285, 73d Cong., 2d Sess. § 220(j), June 1, 1934 (House Committee version), as reported in H. Rep. No. 1850, 73d Cong., 2d Sess. 7 (1934).

Numerous witnesses, including NARUC, conceded that this proposal would change preexisting law by restricting federal-agency power over depreciation.[31] In essence, the amendment would have given the states what they now seek in this Court. The Senate, however, refused to accept this proposed modification; in the final version of the Act, the Senate prevailed and Congress reenacted for the FCC the ICC's preexisting preemptive authority over depreciation.[32] In substance, the state commissions are urging that the Communications Act be read as *if* Congress had adopted in 1934 the very amendment to Section 220 that Congress refused to adopt.[33]

3. Given the FCC's authority over depreciation of jointly used plant and the lack of any statutory bar to preemption, the only remaining question for the Fourth Circuit was whether the FCC had a rational basis for concluding that federal goals would be frustrated if the states adopted inconsistent rules for depreciating the same telephone plant. California's petition offers only a cursory attack on these detailed findings and the Louisiana jurisdictional statement and Florida and Ohio petitions scarcely address the point.

In this case, the FCC provided ample reasons for its conclusion that preemption was required.[34] For example, in adopting remaining life and equal life group, the FCC stressed

[31] *E.g., Hearings on S. 2910 Before the Senate Committee on Interstate Commerce,* 73d Cong., 2d Sess. 181 (1934) (statement on behalf of NARUC).

[32] See S. Rep. No. 781, 73d Cong., 2d Sess. 5 (1934); H. Rep. No. 1918, 73d Cong., 2d Sess. 47 (1934).

[33] It is hard to imagine how Ohio could find any comfort in Section 220(j) as actually enacted. In place of the states' proposed version, which would have granted them a statutory right to set their own depreciation rates, Congress maintained federal authority in Section 220(b), and in Section 220(j) offered the states only the consolation of an FCC "investigation" to consider possible legislation.

[34] The objectives sought by the FCC in its new rules are described in its 1980 and 1981 orders (83 F.C.C.2d at 270-92 and 85 F.C.C.2d at 819-30). The ways in which these objectives and other FCC policies would be undermined by inconsistent state depreciation are described in 1983 Decision ¶¶ 30-40 (A-41 to A-47).

that the resulting more accurate depreciation would improve timely capital recovery and permit telephone companies to modernize plant more rapidly. It followed that, if a state could insist on slower and less accurate depreciation for a portion of the investment in precisely the same switch or cable, this federal policy would be frustrated. See 1983 Decision ¶¶ 35-38 (A-44 - A-46). A telephone company does not buy a percentage of a new cable or switch but pays for the whole facility and must recover the whole cost through timely depreciation. If the new cable or switch is not acquired when needed, it is interstate as well as intrastate service that suffers.[35]

Sustaining federal-agency preemption in *de la Cuesta,* this Court emphasized that "it is neither our function, nor within our expertise, to evaluate the economic soundness of the [agency's] approach." 458 U.S. at 169-70. Given the technical nature of depreciation policy and the FCC's detailed rationale, no court of appeals could properly have found that the FCC's preemptive action was "clearly wrong." [36] Certiorari is not warranted to reexamine the agency's decision here that inconsistent state depreciation methods would frustrate federal interests.

Finally, Ohio argues that an evidentiary hearing was required, claiming a lack of "empirical evidence of an actual conflict." Ohio Pet. 15-16. However, no one disputes that some states have adopted depreciation methods inconsistent with those of the FCC,[37] and the central controversy involved the FCC's *judgment* that the use of inconsistent methods by the states would frustrate federal policy. The FCC provided an opportunity for parties to submit any relevant factual information in written form, and nothing in the Act mandates a different procedure. The use of written submissions accords

[35] The FCC also described other adverse effects on federal policy, including the threat to the FCC's regulation of separations. By insisting on slower and less accurate depreciation for a portion of the same facility, a state could effectively shift a greater portion of the cost to interstate rates. 1983 Decision ¶ 39 (A-47).

[36] *United States* v. *Shimer, supra,* 367 U.S. at 782. See also *Capital Cities Cable, Inc.* v. *Crisp,* quoted at p. 10, above.

[37] See 1983 Decision ¶ 37 (A-45). In fact, even after the FCC's preemption decision, several states sought to ignore the FCC's depreciation rules. See pp. 18-19, below.

with the FCC's prior practice in earlier cases, including the *NCUC* and *Computer II* cases, where its preemptive actions were sustained by the courts.

II. The Decision Below Does Not Preempt the Field of Intrastate Ratemaking, Reverse Long-Established FCC Practice or Warrant Certiorari Because of Its Relation to Any Other Pending Case.

1. The state commissions broadly assert that the FCC has virtually preempted all intrastate ratemaking. The FCC's action is described as a "historic move" (Calif. Pet. 8) and a "dramatic clash" between competing sovereigns over control of intrastate ratemaking. La. J.S. 19, 22. In fact, the FCC's action in this case is restricted solely to depreciation, and it involves a section of the Act that, in its language and legislative history, is directly concerned with depreciation.

Intrastate ratemaking has not been preempted by the FCC's action here. As conceded below by the state commissions,

> "the preemption order affects neither the myriad of other factors affecting the total revenue requirement, which must be derived from the aggregate of individual prices, nor the prices for individual services (rate design)." [38]

In other words, the FCC's decision on depreciation affects only a single element in the ratemaking equation.[39] It does not determine the total revenue requirement for intrastate services (which includes numerous investment and expense categories),

[38] Brief, p. 37, filed by the petitioner Virginia State Corporation Commission in the court below, and joined *inter alia* by the Ohio, Florida and California commissions.

[39] Furthermore, so far as depreciation does affect rates, its impact is more complex and evenhanded than the petitions suggest. Recognizing depreciation when it occurs, instead of deferring it to later years, may enlarge the depreciation expense in an earlier year; but such an action not only reduces depreciation expenses in succeeding years but reduces more rapidly the net investment on which a return is earned. Ultimately, timely recognition of depreciation should lead to lower overall rates as well as better service to the public.

or the rate of return on intrastate investment, or the allocation of the intrastate revenue requirement among the many intrastate services. All of these matters, central in establishing intrastate rates, remain the province of the states.[40]

Because the FCC's authority over depreciation rests directly on Section 220, it is equally unsound for Ohio (Pet. 19) to suggest that the "rationale" of the Fourth Circuit decision automatically extends FCC authority to every aspect of ratemaking. It is a familiar, but unconvincing, tactic to argue for certiorari on the ground that the agency may in a later case take some different measure that may be beyond its authority. Agency preemption depends on the precise action taken and the agency's stated reasons. The time to consider FCC preemption of intrastate rates will occur if and when the FCC ever seeks to take such action.[41]

2. Both California and Louisiana contend that in the past the states have set their own depreciation rates for jointly used telephone plant and they assert that the FCC's preemption order is therefore inconsistent with past practice. As the Court of Appeals found, for many years state commissions have tended voluntarily to follow federal directives on depreciation. 737 F.2d at 394 (A-12). Thus, with rare deviations, actual practice, continued over 40 years, has been consistent with the FCC's superintendence of depreciation, and it was only recently

[40] Congress clearly understood that various FCC actions would affect both interstate and intrastate rates. In fact, a first step in determining both sets of rates is to allocate investment and expenses between interstate and intrastate services, and this allocation is made by the FCC. See p. 3, n.3, above.

[41] Louisiana is singularly misleading in citing to an enforcement action against it. The Louisiana commission, enjoined by the district court to respect the FCC's depreciation rules, responded in a way that the district court found to disregard its injunction. The district court's choice of remedy did not represent FCC preemption but rather the exercise of federal-court jurisdiction to assure that federal injunctions are respected. See *South Central Bell Telephone Co.* v. *Louisiana Public Service Comm'n*, 744 F.2d 1107 (5th Cir. 1984), *appeal pending*, No. 84-870.

that it became necessary for the FCC to assert preemptive authority. See 1983 Decision ¶ 29 (A-40).[42]

Moreover, even if past practice were otherwise, it would not impair the FCC's authority to preempt if and when the FCC found that new conditions warranted that step. Where the federal agency itself preempts and makes the required findings, it may well be that states were free to deviate *until* the federal decision to preempt. In *Arkansas Electric Cooperative Corp.* v. *Arkansas Public Service Comm'n*, 461 U.S. 375 (1983), this Court made clear that many years of state regulation do not deprive a federal agency of authority to preempt:

> "There may come a time when the [federal agency] changes its present policy, and announces that state regulation of rural power cooperatives is inconsistent with federal policy. If that were to happen, and if such a rule was valid under the Rural Electrification Act, *it would of course pre-empt* any further exercise of jurisdiction by [the state commission]." *Id.* at 388-89 (emphasis added).

A discretionary power to preempt through federal agency action is a latent power, which does not preclude state deviation before the power is exercised but does preclude it thereafter. Such a preemptive power means that the agency can, based on proper findings, alter past practice and change the *status quo*.[43]

[42] Most of the examples of alleged state deviation do not involve depreciation or are explained by a specific FCC waiver which for many years has permitted additional, state-required subaccounts "provided such subdivisions do not impair the integrity of the accounts prescribed" by the FCC. See 47 C.F.R. § 31.01-2(d)(1). For instance, of the four court cases cited by Louisiana in one footnote (J.S. 28 n.105), three do not involve depreciation at all; and two of those cases are concerned with different industries under other regulatory regimes. Similarly, of the six state agency authorities cited next by Louisiana (*id.* n.106), four do not involve depreciation in the cited discussion, and in one of the other two the state expressly followed the FCC's determination.

[43] *Northwestern Bell Telephone Co.* v. *Nebraska State Railway Commission*, 297 U.S. 471, 478 (1936). The *Northwestern Bell* case involved the provision of the Interstate Commerce Act that was the direct predecessor of Section 220(b). This Court there read that provision as permitting states to fix depreciation for intrastate telephone service "until" the ICC did so. 297 U.S. at 478-79.

Further, the FCC's latent power is here being exercised not to alter the *status quo* but to maintain it. The states generally followed FCC depreciation rules in the past. The 1983 preemption decision merely assures that this practice will continue.[44]

3. The decision below is consistent with prior decisions in four federal circuits and no conflict exists with any other circuit on the question involved in this case. Nevertheless, California and Louisiana assert that the Ohio Supreme Court has refused to respect the FCC's preemption order and that a number of state commissions have also refused to do so, resulting in several enforcement actions in the federal district courts. Neither circumstance provides a basis for certiorari on the only issue presented by this case, namely, the validity of the FCC's 1983 preemption decision.

The Ohio Supreme Court decision does not constitute a legitimate conflict which justifies plenary review of the issue in this case.[45] This Court made clear only last Term in *FCC* v. *ITT World Communications, Inc.*, 104 S. Ct. 1936 (1984), that the federal courts of appeals have *exclusive* jurisdiction to review FCC orders; the statute clearly precludes any other court from "determin[ing] the validity" of such orders.[46] Under these circumstances, the Ohio Supreme Court lacked authority to pass

[44] *Pacific Gas and Electric Co.* v. *State Energy Comm'n*, 461 U.S. 190 (1983), cited by Florida, did not involve federal agency preemption. There, as this Court expressly found, Congress had *not* granted a federal agency direct authority over economic issues in nuclear plant construction, and the Nuclear Regulatory Commission disclaimed any authority to pass on economic issues in licensing new plants.

By contrast, in this case Congress gave the FCC express authority over depreciation. The agency not only has exercised that authority but it also has made an explicit finding in this case that state use of inconsistent depreciation for the same plant would frustrate federal policy. Under *Capital Cities Cable* and *de la Cuesta*, the FCC's determination is controlling unless irrational.

[45] *Cincinnati Bell Telephone Co.* v. *Public Utilities Commission of Ohio*, 12 Ohio St. 3d 280, 466 N.E.2d 848 (1984), *appeal pending*, No. 84-623.

[46] The Hobbs Act gives the courts of appeals "exclusive jurisdiction" to enjoin, set aside, suspend, or "determine the validity of" an FCC order. 28 U.S.C. § 2342. It would be difficult to frame language more clearly precluding review in any other court.

on the validity of the FCC's 1983 preemption decision, and its views as to the validity *vel non* of a federal agency decision which it may not review cannot give rise to a conflict justifying the granting of certiorari in this case.[47]

Similarly, no conflict exists between the court below and other courts of appeals in whose jurisdictions enforcement actions have been brought to assure compliance with the new depreciation rules.[48] Enforcement courts can decide whether a particular state commission has disregarded a particular federal depreciation rule, but enforcement courts cannot reconsider the validity of the FCC's preemption order affirmed by the Fourth Circuit.[49] Every district and circuit court involved in the enforcement actions has respected the Fourth Circuit's exclusive authority, except for a single district court which was promptly reversed by the circuit court.[50]

[47] The refusal of the Ohio Supreme Court to respect an FCC decision sustained by a federal court of appeals gives rise to other issues that this Court has been asked to review in No. 84-623. However, because the *ITT* case establishes that the Fourth Circuit had exclusive jurisdiction to review the 1983 preemption decision, the pendency of the Ohio case in this Court provides no basis for review of the Fourth Circuit's decision.

[48] *E.g.*, *South Central Bell Telephone Co.* v. *Louisiana Public Service Comm'n*, *supra*, 744 F.2d 1107.

[49] The Fourth Circuit acquired exclusive jurisdiction to review the preemption decision when the first petition to review that order was filed in that circuit. 28 U.S.C. §§ 2112, 2342.

[50] *Southwestern Bell Telephone Co.* v. *Arkansas Public Service Comm'n*, 738 F.2d 901 (8th Cir. 1984), *petition for certiorari pending*, No. 84-483.

CONCLUSION

The Fourth Circuit's decision is consistent with settled preemption doctrine in this Court, with the Communications Act, and with a uniform line of circuit court decisions rejecting, at least six times, the same statutory claims renewed here by the state commissions. The petitions for certiorari should be denied and the appeal should be dismissed for lack of jurisdiction.

Respectfully submitted,

DONALD McG. ROSE*
DAVID HORN
2500 Central Trust Center
201 East Fifth Street
Cincinnati, OH 45202
513-651-6944

Attorneys for Cincinnati Bell Telephone Company

JOHN WOHLSTETTER*
1800 K Street, N.W.
Washington, D.C. 20006
202-466-2895

Attorney for Continental Telecom, Inc.

CAROLYN C. HILL*
JAMES T. ROCHE
1875 Eye Street, N.W.
Washington, D.C. 20006
202-659-4600

MICHAEL BOUDIN*
DAVID H. REMES
ELIZABETH V. FOOTE
1201 Pennyslvania Ave., N.W.
P.O. Box 7566
Washington, D.C. 20044
202-662-6000

Attorneys for AT&T and the Bell Operating Companies (other than Cincinnati Bell, Nevada Bell, and Pacific Bell)

JUDITH A. MAYNES
W. PRESTON GRANBERY
295 North Maple Avenue
Basking Ridge, NJ 07920
201-221-2004

Attorneys for AT&T

MARIA KENDRO
P.O. Box 11315
Kansas City, MO 64112
913-676-3000

Attorneys for United Telephone System, Inc.

ALBERT H. KRAMER*
2000 M Street, N.W.
Washington, D.C. 20036
202-223-6611

Attorney for North American Telecommunications Association

March 1985

**Counsel of Record*

APPENDIX

Subscribing Parties

American Telephone and Telegraph Company

The Bell Telephone Company of Pennsylvania

The Chesapeake and Potomac Telephone Company

The Chesapeake and Potomac Telephone Company of Maryland

The Chesapeake and Potomac Telephone Company of Virginia

The Chesapeake and Potomac Telephone Company of West Virginia

Cincinnati Bell Telephone Company

Continental Telecom, Inc.

The Diamond State Telephone Company

Illinois Bell Telephone Company

Indiana Bell Telephone Company

Michigan Bell Telephone Company

The Mountain States Telephone and Telegraph Company

New England Telephone and Telegraph Company

New Jersey Bell Telephone Company

New York Telephone Company

North American Telecommunications Association*

Northwestern Bell Telephone Company

The Ohio Bell Telephone Company

Pacific Northwest Bell Telephone Company

South Central Bell Telephone Company

Southern Bell Telephone and Telegraph Company

The Southern New England Telephone Company

Southwestern Bell Telephone Company

United Telephone System, Inc.

Wisconsin Bell Inc.

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* Formerly North American Telephone Association.

Rule 28.1 Listing**

Respondent American Telephone and Telegraph Company retains a minority beneficial interest in Cincinnati Bell Inc. held in a voting trust.

Respondents The Bell Telephone Company of Pennsylvania, The Chesapeake and Potomac Telephone Company, The Chesapeake and Potomac Telephone Company of Maryland, The Chesapeake and Potomac Telephone Company of Virginia, The Chesapeake and Potomac Telephone Company of West Virginia, The Diamond State Telephone Company, and New Jersey Bell Telephone Company are subsidiaries of Bell Atlantic Corporation.

Respondent Cincinnati Bell Telephone Company (formerly Cincinnati Bell Inc.) is a wholly-owned subsidiary of Cincinnati Bell Inc. Cincinnati Bell Enterprises Inc. is a wholly-owned subsidiary of Cincinnati Bell Inc. Cincinnati Bell Supply Company, a wholly-owned subsidiary of Cincinnati Enterprises Inc., is a 49 percent partner in a joint venture with Anixter Bros., Inc. Cincinnati Bell Cellular Systems Company, a wholly-owned subsidiary of Cincinnati Bell Enterprises Inc., is a 46 percent partner in a joint venture with American Information Technologies Corporation.

Respondent Continental Telecom Inc. owns 50 percent of American Satellite Company.

Respondents Illinois Bell Telephone Company, Indiana Bell Telephone Company, Michigan Bell Telephone Company, The Ohio Bell Telephone Company and Wisconsin Bell Inc. are subsidiaries of American Information Technologies Corporation.

Respondents The Mountain States Telephone and Telegraph Company, Northwestern Bell Telephone Company and Pacific Northwest Bell Telephone Company are subsidiaries of U S West Inc.

Respondents New England Telephone and Telegraph Company and New York Telephone Company are subsidiaries of NYNEX Corporation.

** Counsel understand S. Ct. R. 28.1 to require disclosure only of those subsidiaries or affiliates with outstanding securities in the hands of the public.

Respondents South Central Bell Telephone Company and Southern Bell Telephone and Telegraph Company are subsidiaries of Bell South Corporation.

Respondent Southwestern Bell Telephone Company is a subsidiary of Southwestern Bell Corporation.

Respondent United Telephone System, Inc., is a subsidiary of United Telecommunications, Inc., which has a minority interest in The Southern New England Telephone Company; respondent's affiliates are United Telephone Company of Arkansas, United Telephone Company of the Carolinas, United Telephone Company of Florida, United Telephone Company of Indiana, Inc., United Telephone Company of Iowa, United Telephone Company of Kansas, United Telephone Company of Minnesota, United Telephone Company of Missouri, United Telephone Company of New Jersey, United Telephone Company of the Northwest, United Telephone Company of Ohio, United Telephone Company of Pennsylvania, United Telephone Company of Texas, Inc., United Telephone Company of the West, Carolina Telephone and Telegraph Company, New Jersey Telephone Company, North Supply Company, and United Inter-Mountain Telephone Company.

Nos. 84-871, 84-889, 84-1054, and 84-1069

2 5 4 3

In the Supreme Court of the United States

OCTOBER TERM, 1984

LOUISIANA PUBLIC SERVICE COMMISSION, APPELLANT

v.

FEDERAL COMMUNICATIONS COMMISSION AND
UNITED STATES OF AMERICA

CALIFORNIA AND PUBLIC UTILITIES COMMISSION
OF CALIFORNIA, ET AL., PETITIONERS

v.

FEDERAL COMMUNICATIONS COMMISSION AND
UNITED STATES OF AMERICA

PUBLIC UTILITIES COMMISSION OF OHIO,
ET AL., PETITIONERS

v.

FEDERAL COMMUNICATIONS COMMISSION AND
UNITED STATES OF AMERICA

FLORIDA PUBLIC SERVICE COMMISSION, PETITIONER

v.

FEDERAL COMMUNICATIONS COMMISSION AND
UNITED STATES OF AMERICA

ON APPEAL AND ON PETITIONS FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

MOTION TO DISMISS AND BRIEF FOR THE FEDERAL RESPONDENTS IN OPPOSITION

REX E. LEE
Solicitor General
Department of Justice
Washington, D.C. 20530
(202) 633-2217

JACK D. SMITH
General Counsel

DANIEL M. ARMSTRONG
Associate General Counsel

JOHN E. INGLE
Deputy Associate General Counsel
Federal Communications Commission
Washington, D.C. 20554

27pp

QUESTION PRESENTED

Whether the court of appeals correctly held that the Federal Communications Commission acted within the scope of its authority in determining that its prescription of certain depreciation practices for telephone equipment preempted state commissions from prescribing inconsistent depreciation practices.

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LOUISIANA PUBLIC SERVICE COMMISSION, APPELLANT

v.

FEDERAL COMMUNICATIONS COMMISSION AND UNITED STATES OF AMERICA

No. 84-889

CALIFORNIA AND PUBLIC UTILITIES COMMISSION OF CALIFORNIA, ET AL., PETITIONERS

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FEDERAL COMMUNICATIONS COMMISSION AND UNITED STATES OF AMERICA

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PUBLIC UTILITIES COMMISSION OF OHIO, ET AL., PETITIONERS

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ON APPEAL AND ON PETITIONS FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

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OPINIONS BELOW

The opinion of the court of appeals is reported at 737 F.2d 388 and is reproduced in the Appendix to the Jurisdictional Statement (at A1-A23) in No. 84-871 (Louisiana)). The order of the FCC (the *Preemption Order*") is reported

at 92 F.C.C. 2d 864 and is reproduced at J.S. App. A24-A60.

JURISDICTION

The judgment of the court of appeals was entered on June 18, 1984, and petitions for rehearing and suggestions of rehearing *en banc* were denied on October 3, 1984 (J.S. App. A90). The appellant in No. 84-871 filed its notice of appeal on November 27, 1984 (J.S. App. A92), and purports to invoke this Court's jurisdiction under 28 U.S.C. 1254(2). The petitions for a writ of certiorari in Nos. 84-889, 84-1054, and 84-1069 were filed on December 10, 1984, January 2, 1985, and January 2, 1985, respectively, and invoke this Court's jurisdiction pursuant to 28 U.S.C. 1254(1). The appellant in No. 84-871 asks the Court to treat its jurisdictional statement as a petition for a writ of certiorari pursuant to 28 U.S.C. 1254(1) if the Court determines that an appeal does not lie.

STATEMENT

Local telephone companies are subject to regulation by both state and federal authorities. In 1980 and 1981, the Federal Communications Commission (FCC) adopted two orders changing the regulations that govern depreciation of certain telephone company equipment so as to bring those regulations into harmony with new competitive and technological realities in the industry. On requests for clarification of the effect of those orders on state agency ratemaking, the FCC declared that its new depreciation policies preempted inconsistent state agency actions. The Fourth Circuit upheld the FCC's ruling that its depreciation orders were preemptive.

1. The Communications Act of 1934 (the Act) grants plenary authority over interstate communications to the FCC (47 U.S.C. 151); and it reserves the regulation of purely intrastate service to the states (47 U.S.C. 152(b)). See, *e.g., North Carolina Util. Comm'n* v. *FCC (NCUC II)*, 552 F.2d 1036, 1044-1050 (4th Cir.), cert. denied, 434 U.S. 874 (1977). Complementary federal and state regulation of telecommunications under the Act generally has worked, and jurisdictional disputes were infrequent until the mid-1970s.[1] The FCC typically confined its attention to interstate service and acquiesced in state regulation of most aspects of local exchange service, asserting the full breadth of its regulatory authority only where there was a need for uniformity in the rules governing jointly-used property or where federal policies might be undercut by fragmented regulation (J.S. App. A40).

In recent years, however, federal policies encouraging competition often have confronted state regulatory policies that are more conducive to the continued monopoly provision of services and equipment (*id.* at A41). In several instances, the FCC has asserted its own authority as paramount and has declared that conflicting state regulation is invalid. The courts uniformly have affirmed the FCC's assertions of primacy in the regulation of jointly-used telecommunications services and facilities, including FCC actions in matters directly affecting state agency regulation of intrastate rates, where the FCC's actions were within its statutory authority.[2]

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[1]The conflicting claims of federal and state regulatory authority arise from the fact that the same local exchange facilities normally are used for both interstate and intrastate communications. Section 2(a) of the Communications Act authorizes the FCC to regulate those facilities insofar as they are used for interstate calls; Section 2(b) reserves jurisdiction to the states insofar as the facilities are used for intrastate calls. 47 U.S.C. 152(a) and (b); see *North Carolina Util. Comm'n* v. *FCC (NCUC I)*, 537 F.2d 787, 793-795 (4th Cir.), cert. denied, 429 U.S. 1027 (1976).

[2]*E.g., Computer & Communications Industry Ass'n* v. *FCC*, 693 F.2d 198 (D.C. 1982), cert. denied, 461 U.S. 938 (1983); *New York Tel. Co.* v. *FCC*, 631 F.2d 1059 (2d Cir. 1980); *California* v. *FCC*, 567 F.2d 84 (D.C. Cir. 1977), cert. denied, 434 U.S. 1010 (1978); *Puerto Rico Tel. Co.* v. *FCC*, 553 F.2d 694 (1st Cir. 1977); *NCUC II, supra; Sherdon* v. *Dann*, 193 Neb. 768, 229 N.W.2d 531 (1975); cf. *General Tel. Co.* v. *FCC*, 449 F.2d 846 (5th Cir. 1971).

2. A part of the function of regulating telephone company service is the determination of depreciation expenses to be allowed so that carriers may recover funds invested in equipment over the economic life of the equipment.[3] Section 220(b) of the Act authorizes the FCC to prescribe "classes of property" for which depreciation may be charged and to prescribe depreciation procedures; it states that the carriers "shall not" use any other classifications or depreciation procedures. The FCC is required, before prescribing any depreciation procedures, to "notify each State commission" and to "receive and consider" the views and recommendations of such commissions (Section 220(i)). The Commission may except the carriers in any state from its prescribed depreciation procedures, where such carriers are subject to state commission regulation, "if it deems such

[3]A regulated carrier is entitled to an opportunity to earn a fair return on investment and to recover its reasonable and prudent expenses through rates for service. The carrier's revenue requirement includes operating expenses, taxes, depreciation expenses, and a return on the investment rate base. In public utility regulation, depreciation affects both the rate base and the expense element of the revenue requirement. The original cost of a given item of equipment goes into the rate base when that item enters service. As the item depreciates over time — as a function of "wear and tear" or technological obsolescence — the original cost in the rate base is amortized, according to a schedule that is based on the item's expected useful life. The annual depreciation charges accumulate in an account known as the depreciation reserve, which theoretically would equal the depreciable cost of the item at the end of the process. The depreciation reserve is a measure of the extent to which the carrier has recovered its investment in equipment. See P. Garfield & W. Lovejoy, *Public Utility Economics* 44-83, 94-114 (1964); see also 1 A. Kahn, *The Economics of Regulation* 117-122 (1970).

For example, a truck with an original cost of $10,000 and an expected life of 10 years would enter the rate base as a $10,000 item to be depreciated over 10 years. The carrier would be entitled to an opportunity to recover a reasonable return on the rate base, including the cost of the truck. Each year's depreciation would diminish the rate base by $1,000 and add an "expense" charge of $1,000 to the revenue requirement for that year.

action consistent with the public interest" (Section 220(h)). Thus, the Act gives the FCC primary authority to prescribe depreciation practices.[4]

The two substantive FCC orders underlying this case made three changes in the agency's depreciation prescriptions. In *In re Property Depreciation (ELG Order)*, 83 F.C.C.2d 267 (1980), reconsideration denied, 87 F.C.C.2d 916 (1981)), the FCC substituted "equal life group" depreciation in place of "vintage grouping." Grouping of telephone company equipment for depreciation purposes is required because telephone companies have so many individual items of equipment that it is not practical to depreciate each item individually. Under vintage grouping all items of a similar type installed in a year are depreciated over the average useful life for the group, even though the group might contain equipment with widely varying life expectancies. Under the equal life group method, the groups are smaller and include only those items whose expected lives

[4]The Commission has prescribed uniform accounting systems and depreciation procedures for many years, and the states generally have accepted the prescriptions and followed them. See, *e.g.*, *American Tel. & Tel. Co.* v. *United States*, 299 U.S. 232 (1936) (the organization representing state commissions joined the FCC as a party defendant in a petition for review of an accounting prescription). A practice has developed over the years in which representatives of the FCC, individual carriers, and the appropriate state agency hold periodic "three-way meetings" to agree upon depreciation rates that are consistent with the FCC's more general prescriptions. *E.g.*, *Prescription of Revised Percentages of Depreciation*, 88 F.C.C.2d 1223, 1225 (1982). Through those meetings, the FCC generally has been able to accommodate the special concerns of state agencies without compromising its own depreciation policies unduly. The FCC also has allowed exceptions from general rules for particular states, as Section 220(h) permits, where that would not undermine federal policy or conflict with the public interest. See, *e.g.*, *In re Amendment of Part 31*, 68 F.C.C.2d 902, 906-907 (1978).

are approximately equal.[5] The principal advantages of the ELG method are greater accuracy in allocation of costs and faster capital recovery for equipment with shorter lives. 83 F.C.C.2d at 277-286.[6]

The second revision in the *ELG Order* — adoption of the "remaining life" method in place of the "whole life" method (83 F.C.C.2d at 288-290) — deals with the problem of correcting for errors in forecasts of useful life. Under the "whole life" approach, the FCC required carriers to calculate depreciation charges each year as if the whole life of assets had been correctly estimated from the beginning, even when that estimate was erroneous. Under the remaining life method, there is a correction for erroneous forecasts in the length of useful life. This method permits carriers to allocate any unrecovered depreciation over the corrected remaining life estimate.[7]

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[5]For example, a vintage group might include all the new cable purchased in a given year, even though some of the cable might be expected to last several times as long as some other cable. The "life" for the vintage group would be the average life for all items in the group. In contrast to vintage grouping, there might be several equal life groups of cable for a single year; for example, an equal life group might include all the new cable purchased in a given year that has an expected useful life of five years.

[6]The depreciation method is the same under equal life and vintage grouping: straight-line depreciation over the average life of the items in the group.

[7]For example, an asset might be depreciated at 10% a year, on the assumption that it would last for 10 years. In the fourth year, after 30% depreciation, the "correct" useful life estimate might be revised to five years because of technological or competitive developments that would hasten the asset's obsolescence. Under the whole life method, the depreciation for the fourth and fifth years would be 20% a year, on the new assumption that it was known all along that the asset would last only five years. But the total depreciation for this asset under that method would be only 70% of the depreciable cost — 30% for the first three years and 40% for the last two. Under the remaining life method, the depreciation for each of the last two years in this example would be 35%, so as to recover all of the depreciable cost that remained unrecovered when the correction was made.

In *In re Uniform Systems of Accounts (Inside Wiring Order)*, 85 F.C.C. 2d 818 (1981)), the FCC determined that one class of property it earlier had prescribed as depreciable — inside wiring[8] — no longer should be capitalized and depreciated but should be treated as a current expense. Like the *ELG Order*, the *Inside Wiring Order* had its origins in relatively recent developments in communications markets and technology. The FCC decided that continuing to depreciate this expenditure over time had the same potential for out-of-phase capital recovery and for misallocation of costs among customers that had prompted the changes to equal life grouping and remaining life depreciation,[9] and so it removed inside wiring from the prescribed list of depreciable property.

Although the FCC and state agencies participating in the docket anticipated some immediate effect on rates (83 F.C.C.2d at 284-285, 293), no one sought review of the *ELG Order*. No party sought review of the FCC's *Inside Wiring Order* either.

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[8]"Inside wiring" for purposes of this decision includes the costs of material and labor associated with the installation of wiring inside the premises of a business or residence. It does not include categories of wiring that are considered permanent and might properly be capitalized as investment in plant of more general utility. 85 F.C.C.2d at 823-826.

[9]Competitive provision of many of the elements of station connections, including inside wiring, had made it necessary for the FCC to consider the propriety of continuing to impose such costs on the general body of ratepayers through capitalization and depreciation charges. The FCC decided that customers who had obtained station connections from sources other than the telephone company should not have to pay telephone rates that include depreciation and a return on investment generated by the telephone company's provision of station connections for other customers. The FCC already had concluded in a 1977 rate decision that "the causative ratepayer should bear the full burden of the costs of station connections" (*In re AT&T*, 64 F.C.C. 2d 1, 54-56 (1977); see also *Inside Wiring Order*, 85 F.C.C.2d at 819-820); 44 Fed. Reg. 48988 (1979)).

3. Two parties representing state agencies asked the FCC to clarify the preemptive effect of its depreciation decisions.[10] The Commission first decided, by a 4-3 vote, that its depreciation orders did not require the state commissions to follow the federal policy in their ratemaking proceedings.[11] On reconsideration the Commission unanimously ruled that state commissions had to follow its depreciation orders (J.S. App. A24).

The FCC decided, first, that Section 220(b) of the Communications Act forecloses the states from adopting depreciation rates and procedures different from those the FCC has prescribed unless the FCC has expressly excepted carriers in particular states from its prescription. The Commission noted that the plain language of the statute provides that "the Commission 'shall' make depreciation prescriptions, and that carriers 'shall not' charge depreciation different than that prescribed by the Commission" (J.S. App. A32). Other provisions of Section 220 are consistent with this plain reading — Section 220(i) requires that "states be given an opportunity to comment" before the FCC prescribes depreciation practices (J.S. App. A32) and Section 220(h) gives the FCC discretionary authority to grant exceptions to its depreciation prescriptions for carriers

[10]NARUC Petition for Clarification (in CC Docket No. 79-105) (filed Apr. 30, 1981); California PUC Petition for Reconsideration (in CC Docket No. 79-105) (filed Apr. 29, 1981).

[11]The majority in that order held that Section 220 of the Communications Act in itself did not preempt the states from adopting accounting procedures that were different from those prescribed by the FCC (J.S. App. A61). It recognized that the FCC's actions under Section 220 could preempt "state regulatory actions that might interfere with or tend to frustrate policies or rules we have adopted," but saw "no occasion" to override state actions in this instance (J.S. App. A84). The dissent contended both that the Commission had intended its depreciation rules to be preemptive and that it was necessary for them to be so if the federal policies were to be realized (J.S. App. A86-A89).

" 'subject to state commission regulation' " (J.S. App. A32). The legislative history also supports a plain reading of Section 220(b), the Commission concluded, since Congress considered and rejected a provision that would have given states the power to prescribe separate depreciation rules for intrastate purposes (J.S. App. A35-A37).

Alternatively, the FCC found that even if the statute itself does not preempt the states, preemption is necessary in this case. The FCC had adopted its new depreciation rules in furtherance of a newly adopted policy of "encouraging competition wherever the market conditions will support such a policy," and its new depreciation prescriptions are needed to make the "marketplace * * * operate efficiently" (J.S. App. A44). It concluded that inconsistent state depreciation rules could give "improper signals * * * to the market" (*id.* at A45). Indeed, since 75% of the cost of affected equipment is allocated to intrastate use, adoption of inconsistent depreciation measures by the states that improperly timed capital recovery would likely "delay or prevent modernization" (*id.* at A46).[12] The FCC concluded

[12]The FCC's concern that some states would not follow its depreciation prescriptions has proven correct. Although an appellate review proceeding was initiated promptly in a court with jurisdiction to stay the FCC's preemption order, not one of the many state parties involved in that proceeding sought a judicial stay. Yet a number of state agencies ignored both the substantive depreciation orders and the subsequent preemption decision in denying telephone company rate changes that purportedly were designed to carry out the FCC's prescriptions. See, *e.g.*, *South Central Bell Tel. Co.* v. *Louisiana Public Service Comm'n*, 570 F. Supp. 227 (M.D. La. 1983), aff'd, 744 F.2d 1107 (5th Cir. 1984), jurisdictional statement pending, No. 84-870; *Southwestern Bell Tel. Co.* v. *Arkansas Public Service Comm'n*, 738 F.2d 901 (8th Cir. 1984), petition for cert. pending, No. 84-483.

that "it is essential to preempt inconsistent state deprecia-tion practices to avoid frustration of * * * vital national policies" (*id.* at A48).[13]

4. The court of appeals affirmed the FCC's *Preemption Order* on June 18, 1984. The court found it "unnecessary to decide" whether Section 220(b) requires preemption as a matter of law (J.S. App. A8). Instead, applying this Court's decision in *Fidelity Federal Savings & Loan Ass'n* v. *de la Cuesta,* 458 U.S. 141 (1982), the court of appeals held that the FCC had validly exercised its power to preempt. Under *de la Cuesta,* the court of appeals noted, the test is whether the FCC "meant to preempt, and whether such preemptive action is within the scope of the agency's authority" (J.S. App. A10; citing 458 U.S. at 154). Since the FCC clearly intended to preempt, the issue was whether the FCC acted within the scope of its authority. The court noted that "improper capital recovery does pose a true threat in today's competitive market" (J.S. App. A12). Although it would be possible to keep separate books for intrastate purposes, if state depreciation practices failed to reflect actual depreciation rates properly, "interstate service would then suffer the effects of delayed innovation" since the same equipment is used for intrastate and interstate purposes (*id.* at A13-A14). The court of appeals acknowledged that the FCC's decision would affect intrastate rates, but added that "the effect will only be ancillary to the FCC's primary statutory directive to regulate interstate communications" (*id.* at A11). The Fourth Circuit noted that is own prior decisions and those of other circuits uniformly permitted preemption by the FCC when necessary to advance federal

[13]The FCC also granted a petition for a declaratory ruling, at the request of General Telephone Co. of Ohio, declaring that the Ohio Public Utilities Commission had acted inconsistently with the ELG Order when it had refused to allow rate increases that sought to imple-ment the new depreciation rules (J.S. App. A48-A49).

policy, even though preemption would affect intrastate rates (*id.* at A14-A16). The court concluded that the FCC had acted "within its authority to ensure efficient operation of the interstate telephone network" (*id.* at A11).[14]

ARGUMENT

The Court should dismiss the Louisiana Public Service Commission's attempt to invoke the Court's appellate jurisdiction under 28 U.S.C. 1254(2) because the decision below did not expressly strike down any state statute. The Court should deny the petitions for certiorari because the court of appeals correctly decided the preemption issue in accordance with well-established precedent, because there is no legitimate conflict between that decision and the deci-sion of any other court, and because the case does not raise important legal questions that this Court should address.

1. The Louisiana Commission seeks review by appeal under 28 U.S.C. 1254(2), which authorizes an appeal when "a State statute [is] held by [the] court of appeals to be invalid as repugnant to the Constitution." It contends that the court of appeals affirmed a ruling that invalidates state ratemaking orders, which are legislative in nature in Louisi-ana (Pet. 3-4). An appeal does not lie, however, because the Fourth Circuit did not expressly strike down any particular state ratemaking order.

"[S]tatutes authorizing appeals [to this Court] are to be strictly construed" (*Silkwood* v. *Kerr-McGee Corp.,* No. 81-2159 (Jan. 11, 1984), slip op. 7). An appeal under Section 1254(2) is available only in those cases "in which a state statute is expressly struck down on constitutional grounds" (slip op. 7). Where an exercise of state authority is

[14]Judge Widener, who dissented in the *NCUC II* and *NCUC I* cases, dissented here as well, primarily on the ground that in his view the FCC had not established the need for federal preemption (J.S. App. A21).

invalidated in the court of appeals without reference to the state statute, a direct appeal does not lie (*ibid.*). The court of appeals held, on review of the FCC's *Preemption Order,* that inconsistent state ratemaking actions had to give way to the preemptive effect of the FCC's depreciation prescriptions (J.S. App. A8-A17). As in *Silkwood,* the court of appeals "did not mention" any particular state statute or rate order and did not purport to review any such statute or order (see *Silkwood,* slip op. 8). Accordingly, this case is not within the Court's appellate jurisdiction,[15] and the jurisdictional statement in No. 84-871 should be treated as a petition for a writ of certiorari pursuant to 28 U.S.C. 2103.[16]

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[15]Louisiana cites *Atchison, Topeka & Santa Fe Ry.* v. *Public Utilities Comm'n,* 346 U.S. 346 (1953), and *Lake Erie & Western R.R.* v. *State Public Utilities Comm'n,* 249 U.S. 422 (1919), in support of its invocation of the Court's appellate jurisdiction. In *Atchison, Topeka & Santa Fe,* a state court rejected a claim that a particular state commission's order violated a party's federal constitutional rights; this Court concluded that the case was properly before it on appeal under 28 U.S.C. 1257(2) (346 U.S. at 348-349). *Lake Erie & Western* also involved a federal constitutional attack on a particular state commission's order which was rejected by a state court; the Court found the order "legislative in nature" and hence a "state law" for purposes of the statutes regulating the court's appellate jurisdiction (249 U.S. at 424). Neither case is pertinent because the Fourth Circuit did not mention, much less strike down, any particular state rate order.

Louisiana also contends that the Fifth Circuit, in another case (*South Central Bell Telephone Co.* v. *Louisiana Public Service Commission,* 744 F.2d 1107 (5th Cir. 1984), jurisdictional statement pending, No. 84-870), upheld a district court injunction ordering a rate increase in Louisiana. But the court in *South Central Bell* did not invalidate a state statute on constitutional grounds; it merely imposed a specific remedy for violation of its order. In any event, the Fifth Circuit's action is not the action challenged by Louisiana's jurisdictional statement in this proceeding, which challenges the Fourth Circuit's decision upholding the *Preemption Order.*

[16]Should the Court disagree with our submission that Louisiana's appeal is not within this Court's appellate jurisdiction, the judgment in No. 84-871 should be affirmed for the reasons stated in the remainder of this brief.

2. The court of appeals correctly applied well-established preemption principles in affirming the FCC's order. On the same day the Fourth Circuit issued its decision in this case, this Court in *Capital Cities Cable, Inc.* v. *Crisp,* No. 82-1795 (June 18, 1984), reiterated those principles as follows: "[I]f the FCC has resolved to pre-empt an area of * * * regulation and if this determination 'represents a reasonable accommodation of conflicting policies' that are within the agency's domain, * * * we must conclude that all conflicting state regulations have been precluded" (slip op. 7, quoting *United States* v. *Shimer,* 367 U.S. 374, 383 (1961)). As the court of appeals concluded, the FCC's decision to preempt inconsistent state depreciation practices was permissible under this standard. The FCC has explicit authority under Section 220(b) comprehensively to prescribe depreciation practices; it clearly expressed its intention that its recent depreciation orders preempt inconsistent state practices; and the FCC's resolution of conflicting federal and state statutory policies was well within the scope of its authority.[17] In short, nothing in the court of appeals' decision departs from established preemption principles or warrants their reconsideration.[18]

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[17]Petitioner California contends (Pet. 9-12) that there was no conflict between state and federal depreciation policies. But the FCC outlined in detail the basis for its finding of conflict (J.S. App. A43-A49), and the court of appeals correctly upheld that finding (J.S. App. A12).

Judge Widener, who dissented, disagreed with the merits of the *Preemption Order.* However, whether the FCC's depreciation prescriptions will or will not "increase market efficiency, encourage technological innovation, and otherwise promote competition" (J.S. App. A20) is not a matter for determination by appellate courts. It was not the function of the reviewing court to make an independent appraisal of the economic soundness of the FCC's approach, and this Court does not sit to make such appraisals either. See *Fidelity Federal Savings & Loan Ass'n* v. *de la Cuesta,* 458 U.S. at 169-170.

[18]In addition, although the court of appeals found it "unnecessary to decide" the question, the FCC's decision that Section 220 itself preempted state regulation is sound. The statute requires the FCC to prescribe

3. The petitioners contend that an express reservation of regulatory authority to the states, contained in Section 2(b) of the Communications Act, 47 U.S.C. 152(b), deprives the FCC of authority it might otherwise have to preempt inconsistent state-prescribed depreciation standards.[19] The courts of appeals have rejected this contention repeatedly, and its resurrection in this case presents no occasion for further review. The Fourth Circuit correctly followed the uniform precedent of four circuits in holding that Section 2(b) is no bar to federal preemption of some aspects of state regulation. *Computer & Communications Industry Ass'n* v. *FCC*, 693 F.2d 198 (D.C. Cir. 1982), cert. denied, 461 U.S. 938 (1983); *New York Tel. Co.* v. *FCC*, 631 F.2d 1059 (2d Cir. 1980); *Puerto Rico Tel. Co.* v. *FCC*, 553 F.2d 694 (1st Cir. 1977); *NCUC II*, 552 F.2d 1036 (4th Cir. 1977). See

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the classes of property subject to depreciation and the percentages of depreciation for each such class, and forbids carriers to depart from the FCC's prescriptions (Section 220(b)). The statute is not limited on its face so as to exclude property jointly used for interstate and intrastate communications. The structure of the statute is consistent with preemption in that it requires the FCC to "notify" state agencies before prescribing depreciation standards and to "receive and consider" the views of those agencies (Section 220(i)). The statute also authorizes the FCC to "except" carriers from its prescriptions where such carriers are subject to state regulation "[if the FCC] deems such action consistent with the public interest" (Section 220(h)). This structure would make little sense if there were no congressional intention to preempt.

[19]Section 2(b) reserves to the states the authority to regulate intrastate communications. It provides, in part, that the FCC has no jurisdiction "with respect to * * * charges, classifications, practices, services, facilities, or regulations for or in connection with intrastate communication service by wire or radio of any carrier."

The petitioners also invoke Section 221(b) of the Act, 47 U.S.C. 221(b), which reserves authority to the states to regulate local exchange telephone service in the limited circumstance in which the exchange straddles state lines. Section 221(b) adds nothing to the petitioners' argument. See *Computer & Communications Industry Ass'n* v. *FCC*, 693 F.2d at 216-217.

J.S. App. A14-A17.[20] These cases have held that Section 2(b) preserves state authority over purely intrastate matters, but that the FCC has ample authority under other provisions of the Act to preempt conflicting state regulation. Section 2(b), the courts have said, does not permit the states to issue a regulation which is "formally restrictive only of intrastate communications" but which "in effect encroaches substantially" upon the authority of the FCC (*NCUC I*, 537 F.2d at 791-793).

In *Computer & Communications Industry Ass'n, supra*, the District of Columbia Circuit held that Section 2(b) did not bar federal preemption merely because, as here, preemption affects state ratemaking. There, the FCC had determined that, in order to establish a competitive market for "customer premises equipment" that was used for both interstate and intrastate purposes, that equipment had to be severed from transmission rates and removed from tariff regulation at both federal and state levels (693 F.2d at 215). In contending that preemption was improper, the state commissions there attempted to distinguish the *NCUC* cases on the ground that they did not involve ratemaking. The court rejected that argument, holding that there is no basis for distinguishing between ratemaking and other regulatory functions in drawing the lines between federal and state authority.[21] The court of appeals in the present case

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[20]The Fourth Circuit also cited *General Tel. Co.* v. *FCC*, 413 F.2d 390, 398 (D.C. Cir.), cert. denied, 396 U.S. 888 (1969), which stated that the Communications Act "must be construed in light of the needs for comprehensive regulation and the practical difficulties inhering in state by state regulation of parts of an organic whole."

[21]The court explained:

> We fail to see any distinction in this case between preemption principles applicable to state ratemaking authority and those applicable to other state powers. The operative principle in this

correctly applied the same reasoning in upholding the preemption order here (J.S. App. A14). There is no need for this Court to disturb the well-reasoned body of case law that has developed on the question of regulatory authority over the jointly-used facilities of interstate and intrastate communications.[22]

4. There is no conflict between the decision below and that of any other court with jurisdiction to review the FCC's

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> case is precisely the principle that demanded state preemption in the *NCUC* cases.
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> * * * * *
>
> [T]he Act itself does not distinguish between authority over rates and authority over other aspects of communications. * * * Therefore, conflicting federal and state regulations * * * are no more acceptable under the Act when equipment rates are involved, as here, than when interconnection policies are involved, as in the *NCUC* cases.

693 F.2d at 216.

[22]The Florida petitioner contends that Section 220 itself reserves authority to the states to set intrastate depreciation rates (Pet. 14-15). Nothing in the language or history of that statute supports the contention (see J.S. App. A31-A42). Section 220 authorizes the FCC to prescribe depreciation rates, requires carriers to follow the prescription, and permits (but does not require) the FCC to exempt the carriers in a given state from its prescription if there is state regulation and if the FCC finds that an exemption will serve the public interest. Nothing in that provision can be read reasonably to bar the FCC from preempting state depreciation rules.

The Florida petitioner also errs in asserting (Pet. 17-19) that the decision here conflicts with *Federal Communications Comm'n* v. *Midwest Video Corp.*, 440 U.S. 689 (1979), and *National Ass'n of Regulatory Util. Comm'rs* v. *FCC*, 533 F.2d 601 (D.C. Cir. 1976). Both of those cases dealt with the extent of the FCC's jurisdiction over aspects of cable television, which is subject to FCC regulation that is "reasonably ancillary" to the agency's express authority over broadcasting. In refusing to allow the FCC to extend regulation to matters the courts did not regard as "reasonably ancillary" to broadcasting, neither of those cases held anything that is inconsistent with an assertion of preemptive authority in an area where the agency's substantive powers are express, as here. The specific language quoted from the *NARUC* case (Pet. 19), moreover, expressed only the views of a single judge and was not a part of the holding of the case.

authority to preempt. Petitioners point out that there is a conflict between the opinion below and a ruling of the Ohio Supreme Court that is before this Court on appeal. *Cincinnati Bell Tel. Co.* v. *Public Util. Comm'n,* 12 Ohio St. 3d 280, 466 N.E.2d 848 (1984), jurisdictional statement pending, No. 84-623. But the *Cincinnati Bell* case does not present the type of conflict that warrants review by this Court.

In *Cincinnati Bell,* the Ohio Supreme Court refused to overturn a rate decision of the State Public Utilities Commission where the Ohio Commission's decision had been challenged as inconsistent with the FCC's depreciation rules and its *Preemption Order*. The court held that the FCC's authority to adopt depreciation rules applies only to interstate ratemaking and that the FCC's *Preemption Order* was ultra vires (84-623 J.S. App. A8). The court's opinion contains no independent analysis of the FCC's authority. It quotes from a decision of the United States District Court for the Eastern District of Arkansas denying enforcement of the FCC's *Preemption Order,* states its agreement with that court's analysis, and concludes tersely that the state commission's depreciation methodology was reasonable and lawful. Although the district court decision on which the Ohio court relied already had been reversed by the Eighth Circuit before the Ohio case was decided (*Southwestern Bell Tel. Co.* v. *Arkansas Public Service Comm'n,* 738 F.2d 901 (8th Cir. 1984), petition for cert. pending, No. 84-483, no mention was made in the Ohio court's opinion even of the fact that it had been appealed. Nor did the Ohio Supreme Court address the Fourth Circuit's decision upholding the FCC's preemption order, which is challenged here. In dissent, Justice Brown of the Ohio Supreme Court acknowledged that "the federal circuit courts of appeals have exclusive jurisdiction in this area" and chided the majority for its "callous disregard" of the Fourth Circuit's decision (84-623 J.S. App. A22).

The Court of Appeals for the Fourth Circuit, by virtue of the filing of a petition for review of the *Preemption Order* there, became the exclusive judicial forum with authority "to enjoin, set aside, suspend (in whole or in part), or to determine the validity of" that order (28 U.S.C. 2342; see *Federal Communications Comm'n* v. *ITT World Communications, Inc.*, No. 83-371 (Apr. 30, 1984), slip op. 4). The Ohio Supreme Court had no jurisdiction to rule on the validity of the FCC's order. Its attempt to rule on that question may warrant summary reversal by this Court; but it does not create a conflict that would warrant review of the decision of the only court that may adjudicate the lawfulness of the FCC's order. Otherwise, a court wholly lacking in authority over a matter could create a climate for review in this Court by ignoring the limitations on its own jurisdiction.

5. Contrary to petitioners' claims (Florida Pet. 8-17; Louisiana J.S. 19-22; California Pet. 9-16), judicial affirmance of the *Preemption Order* here does not raise unresolved questions of national consequence that warrant the Court's attention. The FCC resolved important regulatory matters in its depreciation orders and in its *Preemption Order*, but, as we have shown, those determinations and the court's opinion upholding preemption rest on clear statutory authority and well-established legal principles that do not warrant further review.[23]

[23]The fact that the FCC previously had not asserted preemption in the area of depreciation neither undercuts its authority to do so when the occasion arises nor makes this case an unwarranted departure from the past. As the court of appeals found, there had been no need to consider preemption in the past "when state commissions tended voluntarily to follow federal directives" (J.S. App. A12). When the FCC perceived a threat to its implementation of federal statutory policies in the refusal of several state commissions to adhere to the federal prescription, it was entirely reasonable and proper for the FCC to exercise its discretion to preempt for the first time. That discretion, turning as it does on the agency's perception of actual conflict, by its nature would remain unexercised so long as the states generally adhered to federal rules.

Nor does this decision wrest all ratemaking power from the states and repose it in the FCC as petitioners contend (see, *e.g.*, Ohio Pet. 18-19). Depreciation is but one aspect — albeit, a significant one — of the ratemaking formula. State agencies remain free to set the rate of return, to determine the rate base, to consider the legitimacy of expenses, and to design the rate structure — all with an eye to state policies. The court here has merely allowed the FCC to exercise fully its express statutory authority to prescribe depreciation policy without interference from conflicting decisions of state regulatory agencies.

The *Preemption Order* has been followed by a small flurry of litigation between telephone companies and state agencies. *E.g., South Central Bell Tel. Co.* v. *Louisiana Public Service Comm'n*, 744 F.2d 1107 (5th Cir. 1984); *Cincinnati Bell Tel. Co.* v. *Public Util. Comm'n*, 12 Ohio St. 3d 280, 466 N.E.2d 848 (1984). Some of those cases now are before this Court on appeal or petition for certiorari. That litigation, we submit, only further confirms the correctness of the FCC's determination about the need to preempt in order to avoid conflict between state and federal regulation. If there had been no conflict of the kind that has provoked that litigation, there would have been no occasion to preempt. Those cases —none of which properly raises the issue of the FCC's authority to preempt — do not affect the inappropriateness of the *Preemption Order* as a matter for this Court's attention.

Finally, any further consideration of the policy questions raised by the exercise of the FCC's preemptive authority here should be by Congress, which has monitored the matter closely and has considered proposed legislation that would change the existing Section 220 and give authority

over depreciation for intrastate uses to state agencies.[24] Congress is well aware of the Commission's decision in this case and in the previous preemption cases, and is the appropriate forum for further consideration of desirable policy in this area.

CONCLUSION

The Court should dismiss the appeal in No. 84-871 for want of jurisdiction and treat the papers on which that appeal was filed as a petition for a writ of certiorari pursuant to 28 U.S.C. 2103. The petitions for a writ of certiorari should be denied.

Respectfully submitted.

REX E. LEE
Solicitor General

JACK D. SMITH
General Counsel

DANIEL M. ARMSTRONG
Associate General Counsel

JOHN E. INGLE
Deputy Associate General Counsel
Federal Communications Commission

MARCH 1985

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[24] See *Universal Telephone Service Preservation Act of 1983*, H.R. 4102, 98th Cong., 1st Sess. (passed by the House of Representatives, Nov. 10, 1983), 129 Cong. Rec. H 9701 (daily ed.). Section 7 of that bill (which was not passed in the Senate and consequently lapsed) would have given the state commissions authority to prescribe depreciation methods.

DOJ-1985-03

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Nos. 84-871, 84-889, 84-1054 and 84-1069

IN THE

Supreme Court of the United States

LOUISIANA PUBLIC SERVICE COMMISSION,
Appellant

v.

FEDERAL COMMUNICATIONS COMMISSION and
UNITED STATES OF AMERICA, et al.,
Appellees

(and three related cases)

ON APPEAL FROM, AND PETITIONS FOR A WRIT OF CERTIORARI TO, THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

GTE'S BRIEF IN SUPPORT OF APPELLEES

RICHARD MCKENNA
One Stamford Forum
Stamford, Connecticut 06904
(203) 965-3078

Counsel of Record for GTE Service Corporation and its affiliated domestic telephone operating companies

Of Counsel:

WILLIAM R. MALONE
One Stamford Forum
Stamford, Connecticut 06904

JAMES R. HOBSON
1120 Connecticut Avenue, N.W.
Washington, D.C. 20036

March 18, 1985

41 pp

QUESTION PRESENTED

Was the Federal Communications Commission acting within the scope of its authority and rationally exercising its expert judgment when, based on (i) the express mandate of Congress contained in Section 220 of the Communications Act, 47 U.S.C. § 220, and (ii) the need to prevent state action interfering with the accomplishment of federal policies and objectives, the agency concluded (a) that its depreciation policies and rates preempt inconsistent state depreciation policies and rates, and (b) that telephone plant used for both interstate and intrastate communication must be depreciated in accordance with FCC prescriptions?

ADOPT CONSOLIDATED MOTION

GTE adopts in all respects the Consolidated Motion to Dismiss or Affirm and Brief in Opposition to Petitions for Certiorari filed jointly by American Telephone and Telegraph Company (AT&T) and various other industry parties supporting the Commission (herein "the Consolidated Motion"). The instant brief is submitted to complement the facts and legal analysis contained in the Consolidated Motion.

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TABLE OF AUTHORITIES

Nos. 84-871, 84-889, 84-1054 and 84-1069

IN THE

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ON APPEAL FROM, AND PETITIONS FOR A WRIT OF CERTIORARI TO, THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

GTE'S BRIEF IN SUPPORT OF APPELLEES

This brief is submitted on behalf of GTE Service Corporation and its affiliated domestic telephone operating companies (herein "GTE"),[1] which were parties supporting the Appellee-Respondent Federal Communications Commission in the court below. This brief demonstrates that the various petitions for certiorari should be denied and the appeal should be dismissed or the lower court's decision summarily affirmed.

The Fourth Circuit affirmed the FCC in its decision that, under the Communications Act of 1934 as amended, 47 U.S.C. § 151 *et*

1. GTE Service Corporation is a wholly-owned subsidiary of GTE Corporation. In compliance with the Court's Rule 28.1, a complete list of all subsidiaries of GTE Corporation is contained in Appendix 1 to this brief.

seq. (herein "the Communications Act"), the depreciation prescriptions issued by the FCC preempt inconsistent state-ordered depreciation policies and rates. *Virginia State Corporation Commission* v. *FCC*, 737 F.2d 388 (4th Cir. 1984) (herein "VSCC"), *aff'g Amendment of Part 31*, 92 F.C.C.2d 864 (1983) (herein the "*1983 Preemption Order*"). An appeal (No. 84-871) was filed by the Louisiana Public Service Commission (herein "Louisiana"); petitions for certiorari were filed by (No. 84-889) the People of the State of California and the Public Utilities Commission of the State of California, the National Association of Regulatory Utility Commissioners (herein "NARUC"), and the regulatory commissions of several other states (collectively referred to herein as "California"), California being supported by an *amicus curiae* brief submitted by the State of Maine and the Maine Public Utilities Commission (herein "Maine"), by (No. 84-1054) the Public Utilities Commission of Ohio (herein "Ohio"), and by (No. 84-1069) the Florida Public Service Commission (herein "Florida"). All such appealing, petitioning and *amicus* parties are referred to collectively herein as "the states."

STATEMENT OF FACTS

The GTE telephone companies, including General Telephone Company of Ohio (GTE of Ohio), were parties to the proceedings before the FCC. GTE of Ohio, and a number of other GTE companies, are fully subject to Title II of the Communications Act, 47 U.S.C. § 201 *et seq.*, in accordance with the provisions of Subsection 2 of the Act, 47 U.S.C. § 152.

After noting that the record indicated a differential for GTE of Ohio of seven million dollars a year in depreciation between levels prescribed by the FCC and those established by the Ohio Public Utilities Commission (*1983 Preemption Order*, 92 F.C.C.2d at 878-879, App. at A-48-49),[2] the FCC concluded that its depreciation policies and rates preempt inconsistent state depreciation policies and rates. As exemplified by this seven million dollar

2. Page references in this brief, shown as "A-1", "A-2", etc., are to the Louisiana Appendices (No. 84-871). This paging also corresponds to that of the Ohio Appendices (No. 84-1054), for those documents

figure, the consequences of such inconsistencies, absent FCC preemption, can place serious risks on the firm caught between the two sovereigns. The record before the FCC showed that use of different methodologies and rates for interstate and intrastate purposes would mean that *the same item of plant* would be depreciated differently (for example, different lives), so that a portion of the plant investment might remain on the books for state purposes when it has been fully depreciated for FCC purposes, or vice versa. Further, the record showed that only sheer chance would produce matching figures in plant accounts for any particular period; and that, under these circumstances, there could be no assurance aggregate revenues generated under federal and state regulation would cover these varying depreciation accruals. *See* Appendix 2, First Excerpt (at 2-1) and Second Excerpt (at 2-3). The FCC concluded, on the basis of its extensive factual record, absent FCC preemption "improper capital recovery could ... ultimately, threaten carriers' ability to fully recover their invested capital." *1983 Preemption Order*, 92 F.C.C.2d at 877, App. at A-46.

SUMMARY OF THE ARGUMENT

The FCC's carefully limited preemption here comes squarely within the standards applied to FCC preemption by this Court and four Circuit courts. Further, the FCC's action is a faithful implementation of explicit Congressional intent. Well-supported findings of the expert agency and the Fourth Circuit justify the *1983 Preemption Order* and *VSCC*. No basis for plenary review has been established. Accordingly, this Court should dismiss the appeal in No. 84-871, or summarily affirm the lower court's decision; and should deny certiorari in Nos. 84-889, 84-1054 and 84-1069.

therein contained. Page references to the GTE Appendices are shown as "1-1", "1-2", etc.

ARGUMENT

THE STATES HAVE FAILED TO SHOW THAT PLENARY REVIEW IS WARRANTED.

I. The scope of the FCC's preemptive action is carefully limited.

Contrary to the states' assertions, the FCC did not preempt the ratemaking process at the state level. Rather, the FCC was careful to limit its preemption within the scope of both established case law and the terms of its governing federal statute. Executing the explicit direction of Congress expressed in Section 220 of the Communications Act, 47 U.S.C. § 220, and deeming it necessary to achieve the statutory goal of an efficient nationwide telecommunications service, the Commission decided to fix one element in the ratemaking calculation: depreciation of plant used jointly for interstate and intrastate communications. "The setting of depreciation rates and classes of depreciable property only resolves a single issue impacting the ratemaking process." *1983 Preemption Order*, 92 F.C.C.2d at 874, App. at A-41. All other elements of the process remain in the hands of state regulatory agencies.

II. The states' arguments against FCC preemption simply ignore the legal principles applied by the courts.

To an astonishing degree, the Jurisdictional Statement and petitions of the states simply ignore the legal principles governing FCC preemption established by numerous decisions of Circuit courts and of this Court. Refusal to recognize the preemption doctrine applied by the federal courts in an FCC context forms the basis for the states' claims of a federal over-reaching. The following brief review of this doctrine, with special reference to Subsections 2(b) and 221(b) of the Communications Act, 47

U.S.C. §§ 152(b) and 221(b), will provide a framework[3] for examining the states' arguments:

First, Congress gave the FCC "unified jurisdiction," "broad authority," and "a comprehensive mandate," with "not niggardly but expansive powers."[4]

Second, the FCC's authority embraces not only its responsibilities explicitly assigned by the Act, but also that which is "reasonably ancillary" to the effective performance of its statutory responsibilities.[5]

Third, the scheme of dual federal and state regulation that underlies the Act grants the FCC jurisdiction over *all* interstate (and foreign) communication by wire or radio; this embraces facilities used for both interstate and intrastate communications.[6]

Fourth, the nature of the communication itself rather than the physical location of the technology determines whether interstate or intrastate communication is involved.[7]

Fifth, notwithstanding Section 2 of the Act, FCC jurisdiction embraces communications facilities that are not

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3. *See generally McKenna, Pre-Emption under the Communications Act*, 37 FED. COMM. L. J. 1, 53 *et seq.* (1985). The author is Counsel of Record for GTE.

4. National Broadcasting Co. v. United States, 319 U.S. 190, 219 (1943); United States v. Southwestern Cable Co. ("*Southwestern Cable*"), 392 U.S. 157, 172-173 (1968). *See also* Capital Cities Cable, Inc. v. Crisp ("*Capital Cities*"), 104 S. Ct. 2694, 2701 (1984).

5. *Capital Cities*, 104 S. Ct. at 2701; United States v. Midwest Video Corp. ("*Midwest Video*"), 406 U.S. 649, 663 (1972), *reh'g denied*, 409 U.S. 898 (1972); *Southwestern Cable*, 392 U.S. at 177-178; Permian Basin Area Rate Cases ("*Permian Basin*"), 390 U.S. 747, 780 (1968).

6. *Southwestern Cable*, 392 U.S. at 173. "[F]ifty states and myriad local authorities cannot effectively deal with bits and pieces of what is really a unified system of communication." General Tel. Co. of California v. FCC, 413 F.2d 390, 401 (D.C. Cir. 1969) (Burger, J.), *cert. denied*, 396 U.S. 888 (1969).

7. *Id.* at 168-169; *Midwest Video*, 406 U.S. at 663 n. 32. "*Every court that has considered the matter* has emphasized that the nature of the communications is determinative rather than the physical location of the facilities used." *NARUC v. FCC, infra*, 746 F.2d at 1498, *emphasis added.*

separable from, or that substantially affect, the conduct or development of interstate communications.[8]

Sixth, Congress may have intended to deny the FCC the kind of jurisdiction over local rates approved in the *Shreveport Rate Case*,[9] but in no other respect did Congress distinguish between FCC authority over rates and over other aspects of communications. *See CCIA* v. *FCC*.[10]

Seventh, while, as a practical matter, intrastate ratemaking has typically been treated as "separable" from interstate ratemaking (*North Carolina I*, 537 F.2d at 793 n.6), FCC preemption will be upheld where intrastate ratemaking substantially affects interstate communications. Thus, the Second Circuit upheld FCC preemption where a state commission required a surcharge on certain interstate customers ranging up to 1600 percent higher

8. North Carolina Util. Comm'n v. FCC ("*North Carolina I*"), 537 F.2d 787, 793-794 (4th Cir. 1976), *cert. denied*, 429 U.S. 1027 (1976); North Carolina Util. Comm'n v. FCC ("*North Carolina II*"), 552 F.2d 1036, 1045-1047 (4th Cir. 1977), *cert. denied*, 434 U.S. 874 (1977); California v. FCC, 567 F.2d 84, 87 (D.C. Cir. 1977), *cert. denied*, 434 U.S. 1010 (1978); Puerto Rico Tel. Co. v. FCC ("*Puerto Rico Tel. Co.*"), 553 F.2d 694, 699-700 (1st Cir. 1977); New York Tel. Co. v. FCC ("*New York Tel. Co.*"), 631 F.2d 1059, 1066 (2d Cir. 1980); Computer and Communications Industry Ass'n v. FCC ("*CCIA* v. *FCC*"), 693 F.2d 198, 215 (D.C. Cir. 1982), *cert. denied sub nom.* Louisiana Pub. Service Comm'n v. FCC, 461 U.S. 938 (1983); Fort Mill Tel. Co. v. FCC ("*Fort Mill Tel. Co.*"), 719 F.2d 89, 91 n. 6 (4th Cir. 1983); National Ass'n of Regulatory Utility Comm'rs v. FCC ("*NARUC* v. *FCC*"), 746 F.2d 1492, 1500 (D.C. Cir. 1984).

9. *North Carolina II*, 552 F.2d at 1047; CCIA v. FCC, 693 F.2d at 216 n. 99. *See* Houston, East and West Texas Ry. Co. v. United States, 234 U.S. 342 (1914). A broad reading of *Shreveport* was rejected by the Fourth Circuit in *North Carolina II*, 552 F.2d at 1047-1049. *See* discussion of *Shreveport* at 20, *infra*.

10. 693 F.2d at 216: "[T]he Act itself does not distinguish between authority over rates and authority over other aspects of communications....[C]onflicting federal and state regulations regarding dual use CPE [Customer Premises Equipment] are no more acceptable under the Act when equipment rates are involved, as here, than when interconnection policies are involved, as in the *[North Carolina] cases.*" Florida (Petition at 20) erroneously cites the *North Carolina* cases, with no page references, as having "determined that intrastate ratemaking was separable from and had no substantial effect on FCC jurisdiction." No such determination is contained in either of the *North Carolina* cases.

than the charge for comparable service to intrastate users. *New York Tel. Co.*, 631 F.2d at 1066.

Eighth, Subsection 221(b) of the Act has no application except to a "straddling" case, *i.e.*, where a metropolitan area extending across state boundaries is being regulated by the state(s) involved.[11]

The established preemption doctrine just discussed is simply left out of the Louisiana, California and Ohio submissions, while Florida (Petition at 3, 19-21) barely acknowledges its existence. Generally, the states reargue FCC preemption as if the important cases of the last two decades did not exist -- using perfunctory citations to these cases only for points of secondary significance.[12] The states paint a picture of a federal agency out of control, exceeding its statutory charter and going far beyond anything ever intended by Congress; but that picture depends on refusing to recognize numerous court decisions construing the statutory language and its underlying intent. The states' arguments, examined in light of the FCC preemption doctrine developed and applied by the courts, prove to be without merit.

III. Similarly, the states ignore Congressional acquiescence in the preemption doctrine applied by the courts.

The states generally ignore Congressional awareness of and involvement in the development of the FCC preemption doctrine applied by the courts. In 1976, responding to similar argumentation, the Fourth Circuit said:

11. *North Carolina I*, 537 F.2d at 795; *North Carolina II*, 552 F.2d at 1045; *Puerto Rico Tel. Co.*, 553 F.2d at 698-699; *New York Tel. Co.*, 631 F.2d at 1064; *CCIA* v. *FCC*, 693 F.2d at 216-217; *Fort Mill Tel. Co.*, 719 F.2d at 91 n. 6; *NARUC* v. *FCC*, 746 F.2d at 1500.

12. For example, Louisiana (Jurisdictional Statement at 24-25) cites *North Carolina II*, but only to support the statement that Congress sought to deny the FCC *Shreveport*-type jurisdiction over local rates (a point not contested); and (at 25-26) cites *CCIA* v. *FCC*, but only to indicate that a decision to deregulate terminal equipment was sustained because of the inseparability of interstate and intrastate usage.

> Congress cannot have been unaware that for some 30 years FCC has viewed and treated section 2(b)(1) of the Act as imposing no bar to its exercise of jurisdiction over facilities used in connection with both intrastate and interstate telephone communications.[13]

Since 1976, the telephone industry has been entirely restructured along competitive lines. A key factor in this restructuring was preemptive FCC decision-making upheld by the courts. *See* note 8, *supra*. Even more emphatically today than in 1976, it must be said that Congress cannot have been unaware of these developments. As pointed out in Judge Bork's recent Opinion in *NARUC* v. *FCC*, in the District of Columbia Circuit:

> Congress has obviously been aware that for nearly forty years the Commission has claimed jurisdiction over some intrastate facilities. Congressional acquiescence in these claims is symbolized by the Joint Federal-State Board procedure of section 410(c). Congress would not have created this procedure in 1971 if it had been concerned that the FCC was inappropriately exercising jurisdiction over matters committed to state regulation. The Joint Board procedure actually augmented the Commission's powers in part by recognizing national primacy.

746 F.2d at 1500, citing *North Carolina I*, 537 F.2d at 795.[14]

13. 537 F.2d at 795, citing (at 794-795) Use of Recording Devices, 11 F.C.C. 1033 (1947); Katz v. AT&T, 43 F.C.C. 1328, 1331-1332 (1953); Jordaphone Corp. of America v. AT&T, 18 F.C.C. 644 (1954); AT&T TWX, 38 F.C.C. 1127 (1965); and Department of Defense v. AT&T, 38 F.C.C. 2d 819 (1970). It is 46 years since the FCC, over the objections of NARUC, asserted Section 214 jurisdiction over facilities entirely within a single state but carrying some traffic of interstate character. Southwestern Bell Tel. Co., 6 F.C.C. 529 (1938).

14. Continuously since 1977, pending before Congress and receiving active consideration were bills that addressed the jurisdictional division between federal and state regulation of telecommunications. *See* for example: H.R. 13015 (95th Cong; 2d Sess.), § 102; S. 2827 (96th Cong.; 1st Sess.), § 103; H.R. 6121 (96th Cong.; 1st Sess.), § 211; S. 1660 and H.R. 3621 (98th Cong.; 1st Sess.), §§ 4, 5, 8 and 9; H.R. 4102 (98th Cong.; 1st Sess.), § 4; S. 898 (97th Cong.; 1st Sess.), § 103. Through the testimony of scores of witnesses, Congress had full knowledge of the preemption doctrine created by the foregoing decisions and of the consequences of this doctrine, but took no action to reverse the

Thus, as two Circuits have stressed, there has been clear Congressional acquiescence in the preemption doctrine applied by the courts. This doctrine is the kind of "reasonable accommodation of conflicting policies... that Congress would have [has] sanctioned" which this Court has said repeatedly it will not disturb:

> If [the agency's] choice represents a reasonable accommodation of conflicting policies that were committed to the agency's care by the statute, we should not disturb it unless it appears from the statute or its legislative history that the accommodation is not one that Congress would have sanctioned.

Capital Cities, 104 S.Ct. at 2700, *quoting Fidelity Federal Savings and Loan Ass'n* v. *de la Cuesta*, 458 U.S. 141, 153-154 (1982), which quoted *United States* v. *Shimer*, 367 U.S. 374, 383 (1961).

Finally, if any doubt remained of Congressional acquiescence in the preemption doctrine applied by the courts, Florida (Petition at 13-14) eliminates that doubt by quoting a report adopted in 1984 by the House of Representatives and substantially adopted by the Senate. Florida uses selective emphasis (but without indicating the emphasis is not in the original) to suggest Congressional disapproval, but the words of the report say expressly that the Committee "does not intend to depart from those [court] interpretations" and limit the effect of Subsection 2(b) to "services that are exclusively local or intrastate in nature":

> The Committee recognizes that the application of Section 2(b) [of the Communications Act] is a complex matter with a long history of interpretation by the courts. The

tide. What relevant action Congress has taken since 1934 maintained FCC jurisdiction, or even increased its extent. *See* (i) the 1943 Amendment, modifications to 47 U.S.C. § 214(a), Act of March 6, 1943, 57 Stat. 11, and the FCC's interpretation, AT&T Co., 10 F.C.C. 315, 318-321 (1944); (ii) the 1954 Amendment, Act of April 27, 1954, modifying 47 U.S.C. §§ 152(b), 153(e) and 221(b), 68 Stat. 63-64; (iii) modifications to 47 U.S.C. § 410 in 1956, Act of August 2, 1956, 70 Stat. 932, and in 1971, P.L. 92-131, 85 Stat. 363; and (iv) the 1982 Amendment, P.L. 97-259, amending 47 U.S.C. § 301, 96 Stat. 1091.

> Committee does not intend to depart from those interpretations in observing that Section 2(b) denies the FCC the authority to regulate common carrier communication services that are exclusively local or intrastate in nature. Section 2(b) does not, however, detract from the FCC's jurisdiction over common carrier communications services that are interstate in character.

The Committee went on to endorse the preemption doctrine established by agency and court decision:

> In particular, [Section 2(b)] does not bar the FCC from regulating such services which are provided over facilities that also carry intrastate common carrier communications. Under Section 2(b) the FCC is barred from regulating those local common carrier services which the states may regulate without infringing upon Federal regulatory authority over rates and terms under which interstate common carrier services are provided.

H. REP. No. 98-934, 98th Cong., 2d Sess. 62 (1984). *See* 130 CONG. REC. 14,285 (1984) and 130 CONG. REC. 12,235 (1984).

The quoted language of the Congressional report reinforces the point stressed by the Fourth and D.C. Circuits as quoted *supra* at 7-8: Congress, with full knowledge, has acquiesced in the preemption doctrine that the states refuse to recognize.

IV. The FCC's carefully limited preemption comes squarely within its established preemptive authority.

The FCC's carefully limited preemptive action raises none of the difficult questions at issue in the various preemption cases discussed *supra* at 5-7. Here there is no need to examine the interstices of the Act for authority, no requirement for an ancillary theory; the fixing of depreciation rates and methodology is one of the FCC's assigned tasks under Title II. The only issue is whether the states may take action that would negate, as a practical matter, the effect of the FCC's discharge of its statutory responsibilities.

After long and careful study of depreciation, the FCC concluded that profound changes in telecommunications require a fresh approach, focussed not on holding down depreciation accruals at all costs but on assuring full and timely capital recovery in the interests of ratepayers as well as investors.[15] Timely capital recovery would "result in faster technological innovation with its accompanying benefits."[16] But "improper capital recovery could delay or prevent modernization which would add to the costs borne by ratepayers and could, ultimately, threaten carriers' ability to fully recover their invested capital."[17] The Commission acted to promote "a dynamic, efficient telecommunications marketplace with services being provided at reasonable prices." The agency recognized that, in the new competitive environment, using proper depreciation methods and rates "is more critical if the proper incentives are to be created to insure that the marketplace will function efficiently to bring the benefits of the competition to the ratepayers of this country."[18]

In view of these critical concerns, after some reluctance,[19] the FCC concluded its depreciation prescriptions under Subsection 220(b) must be effective in achieving full and timely capital recovery; and this means the states must be bound by FCC prescriptions. These conclusions were reached by the expert agency based not only on its general expertise but on years of close

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15. Property Depreciation, 83 F.C.C.2d 267, 280-281 (1980), *reconsideration denied*, 87 F.C.C.2d 916 (1981).

16. *1983 Preemption Order*, 92 F.C.C.2d at 876, App. at A-45.

17. *Id.* at 877, App. at A-46.

18. *Id.* at 877 and 874, App. at A-46 and A-41.

19. Initially, while stressing its power to preempt state actions that might interfere with or tend to frustrate policies or rules the FCC had adopted to carry out statutory objectives, the Commission decided against preempting the states. Amendment of Part 31, 89 F.C.C.2d 1094, 1108 (1982), App. at A-61, A-84. Some months later, in light of unexpected variance by the states from FCC prescriptions (*1983 Preemption Order*, 92 F.C.C.2d at 877 n. 14, App. at A-46), the Commission closely examined the terms of Section 220 and the legislative history of the Act, as well as the need for a policy effective nationwide, and concluded the states must be preempted. *Id.* at 879-880, App. at A-49 and A-50.

examination of the subject and awareness of the new environment the FCC was helping to create.[20]

The Commission's consideration of these matters was directed not merely to the performance of accounting procedures; it was focussed on the *actual recovery of investor capital* -- in the interests of both ratepayers and investors. Thus, the Commission considered the risk to ratepayers of inadequate capital recovery, with ratepayers likely to bear the burden of any depreciation reserve deficiency under *Democratic Central Committee* v. *Washington Metropolitan Area Transit Commission*, 485 F.2d 786 (D.C. Cir. 1973), *cert. denied sub nom. D.C. Transit System, Inc.* v. *Democratic Central Committee*, 415 U.S. 935 (1974). *See Property Depreciation*, 83 F.C.C.2d at 280-281. Taking this into account, the Commission recognized the need for a reform of prior regulatory practices and proceeded to implement this reform. The essence of the Commission's *1983 Preemption Order* was that the states would not be permitted to negate the FCC's policies by denying effective capital recovery in accordance with FCC prescriptions.[21]

20. The FCC's Docket No. 20188 involved an exhaustive study of depreciation over a seven-year period. It included thousands of pages of submissions by industry and state commissions, among others; a special study by Ernst & Ernst, Inc. commissioned by the FCC; and a review of the entire subject of depreciation by Commission staff reflected in a "Primer" made part of the record. Further, the Commission, sitting *en banc*, heard presentations by Commission staff as well as industry spokesmen stressing the critical importance of depreciation in the new environment of telecommunications. Similarly, in its CC Docket No. 79-105, extensive Commission resources were dedicated, over a period of several years, to reviewing the issues in light of more thousands of pages of submissions, again including submissions by state commissions. With active participation by Commissioners, this led first to the Commission's expensing and amortization program for station connections (First Report and Order, 85 F.C.C.2d 818 (1981)); then to the *1983 Preemption Order*. It would be difficult to conceive of an agency conducting a more thorough examination of a subject.

21. The states confuse accounting matters, governed by Subsection 220(a) of the Act, and depreciation, governed by Subsection 220(b). *See* for example Louisiana (Jurisdictional Statement at 10-12). The FCC's direct assertion of preemptive power applies only to depreciation prescriptions and the related accounting under Subsection 220(b). *1983 Preemption Order*, 92 F.C.C. 2d at 870, 873 and 874, 878, App. at A-33, A-39, A-41 and A-42, A-48.

On appeal, the Fourth Circuit found that the FCC's action comes squarely within the Commission's established preemptive authority. *VSCC*, 737 F.2d at 389-390, App. at A-2. Applying the foregoing legal principles, and giving special emphasis to the analysis contained in *Fidelity Federal Savings & Loan Co.* v. *de la Cuesta*, 458 U.S. 141 (1982), the court below found first that the FCC intended to preempt; and then that the FCC's action was "within its authority to ensure efficient operation of the interstate telephone network." *VSCC* at 393, 394, App. at A-11. The Fourth Circuit stressed the guiding principle enunciated by then-Judge Burger in *General Telephone Co. of California* v. *FCC*, *supra* note 6, 413 F.2d at 398, that "[t]he Act must be construed in light of the needs for comprehensive regulation and the practical difficulties inhering in state by state regulation of parts of an organic whole." *VSCC* at 396, App. A-17. Finally, the court below reached the following conclusions:

> [I]t cannot be said that depreciation policies are "separable from" interstate communications. Indeed, the conduct and development of interstate communications would undoubtedly be affected by the states' imposition of depreciation policies that slowed capital recovery and innovation.

Id. at 395, App. A-15.

Thus, the Fourth Circuit applied the key two-pronged test established by the cases. *See* note 8 *supra* and accompanying text. The FCC's decision to preempt the states on depreciation was held to satisfy both prongs, in that: (i) depreciation policies could not be shown to be separable from interstate communications, and (ii) depreciation policies would undoubtedly affect the conduct and development of interstate communications.

Both Commission and reviewing court understood, as did the Congress in 1934,[22] that the same facilities and the same systems

22. The two bills introduced in Congress in February 1934, S. 2910 and H.R. 8301, contained the following rather simplistic limitation on the new federal agency's jurisdiction:

> SEC. 210. Nothing in this Act shall be construed to apply, or to give the Commission jurisdiction, with respect to charges,

provide both interstate and intrastate service. If a state commission refuses to permit a carrier to recover its capital, this refusal will damage the interests of the interstate customer who is dependent on systems employed for both inter- and intrastate purposes. This recognition leads inexorably to the conclusions of the Commission and the Fourth Circuit that depreciation policies are *not* "separable" from interstate communications, and that misguided depreciation policies at the state level *will* adversely affect interstate communications.These rational and well-supported conclusions of the agency and the Fourth Circuit satisfy the relevant legal standards.

How do the states deal with the two-pronged test? Louisiana, California and Ohio never acknowledge the existence of the test applied by four Circuits in eight decisions (*supra* note 8), and Florida (Petition at 13-14) misapplies the test. No serious effort is made by any of the states to show that their position is in harmony with the test. The states fail the test by refusing even to recognize it as an effective standard.

In summary, the decisions of the FCC and the Fourth Circuit come squarely within the cases, meeting all the relevant tests established by Circuit courts and by this Court.

V. The FCC's preemptive action here is a faithful implementation of explicit Congressional intent.

In addition to, and reinforcing, the foregoing analysis, there are specific provisions in the Communications Act showing that the

> classifications, practices, or regulations for or in connection with intrastate communication service of any carrier, or to any carrier engaged exclusively in intrastate commerce.

This provision was replaced by the more sophisticated provisions of Subsection 2(b) of the Act, 47 U.S.C. § 152(b), which applied a limited regulatory scheme to carriers engaged in interstate (and foreign) communications solely through the facilities of non-affiliates. While "almost all telecommunications facilities are physically intrastate," the telephone companies of the United States interconnected with the national communications network employ these facilities to furnish interstate service, and to the degree they do so, these companies are subject to FCC jurisdiction. *See NARUC* v. *FCC*, 746 F.2d at 1498-1500 and cases cited therein.

1934 Congress intended federal primacy for the FCC's depreciation prescriptions. In 1934, Congress (i) granted to the FCC in express terms preemptive responsibility and power over depreciation, and (ii) rejected NARUC and state arguments for a reservation to the states of power over depreciation. Thus, after a careful study of the Communications Act and its legislative history,[23] the Commission properly concluded Congress specifically intended that FCC depreciation prescriptions would preempt the states.[24] The Commission's conclusion is supported by the following findings:

(1) The language of Section 220 of the Communications Act grants preemptive power to the FCC in respect of depreciation. *1983 Preemption Order*, 92 F.C.C.2d at 869-870, App. at A-33.

(2) Congress rejected the version of Subsection 220(j) endorsed by NARUC in 1934; this rejected version would have reserved to the states the power to prescribe depreciation methodology or rates for intrastate purposes.[25]

23. In the interpretation of its statutory charter, the conclusions of the expert agency carry special weight. The agency's construction need not be the only reasonable one, or even the reading the court would have reached if the question initially had arisen in a judicial proceeding. Udall v. Tallman, 380 U.S. 1, 16 (1965); Federal Elec. Comm'n v. Democratic Senatorial Campaign, 454 U.S. 27, 39 (1981). "[T]he construction of a statute by those charged with its execution should be followed unless there are compelling indications that it is wrong...." FCC v. WNCN Listeners Guild, 450 U.S. 582, 598 (1981). *See* Red Lion Broadcasting Co. v. FCC, 395 U.S. 367, 381 (1969).

24. *1983 Preemption Order*, 92 F.C.C.2d at 873, App. at A-39. The Fourth Circuit found it unnecessary to decide whether 47 U.S.C. § 220 itself requires preemption. *VSCC*, 737 F.2d at 392, App. at A-8. Ohio (Petition at 8, 10) mischaracterizes the Fourth Circuit's decision not to reach the question as a finding of "an explicit congressional intent not to preempt...."

25. The NARUC-sponsored version of Subsection 220(j) read as follows:

> Nothing in this section shall (1) limit the power of the State commission to prescribe, for the purpose of the exercise of its jurisdiction with respect to any carrier, the percentage rate of depreciation to be charged to any class of property of such carrier, or the composite depreciation rate, for the purpose of determining charges, accounts, records, or practices, or (2) relieve

(3) Committee reports accompanying the bills passed in 1934 contained language indicating that the committees believed the provision of the Interstate Commerce Act (ICA) corresponding to Section 220 of the Communications Act preempted the states in relation to depreciation prescriptions. Further support for the conclusion that the ICA preempted the states on depreciation included statements on the House floor by Chairman Rayburn, sponsor of the House bill. *Id.* at 871-872, App. at A-36 and A-37. Thus, the 1934 Congress, recognizing the preemptive power of the federal agency regarding depreciation under the ICA, adopted provisions closely following the key ICA provisions. *Id.* at 872-873, App. at A-38.[26]

(4) Accordingly, the legislative history "supports the construction that Section 220(b) preempts inconsistent state action where the Commission has prescribed depreciation rates for a carrier." *Id.* at 873, App. at A-39.

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any carrier from keeping any accounts, records, or memoranda which may be required to be kept by any State commission in pursuance of authority granted under State law.

26. The Commission found that Congress settled on the provisions of Section 220 with the Congressional committees "believ[ing] that the predecessor provision of the Interstate Commerce Act had preempted the states." *1983 Preemption Order*, 92 F.C.C.2d at 871-872, App. at A-36 and A-37. As explained *supra*, Congress in 1934 rejected the NARUC-sponsored version of Subsection 220(j) reserving power to the states in favor of the present Subsection 220(j) calling on the FCC to investigate and report to Congress. The 1934 Congress also created new provisions in Subsection 220(h) (power to prescribe differently for different classes of carriers or except different classes from requirements) and in Subsection 220(i) (notification to the states and opportunity for the states to present views). In other respects, Section 220 as adopted closely tracks corresponding provisions of what was then ICA Section 20. *Compare* APPENDIX 3 and APPENDIX 4. The key wording of Subsection 220(b), following almost *verbatim* ICA § 20(5) [later 49 U.S.C. § 20(4)], reads: "The Commission shall...prescribe for such carriers the classes of property for which depreciation charges may be properly included under operating expenses, and the percentages of depreciation which shall be charged....*Such carriers shall not...charge to operating expenses any depreciation charges on classes of property other than those prescribed by the Commission, or...charge...a percentage of depreciation other than that prescribed therefor by the Commission.*" (Emphasis added.)

In summary, the issue of depreciation preemption was specifically considered by the Congress in 1934. As concluded by the expert agency after careful review, the wording of the Act, supported by its legislative history, makes it clear that the conclusion reached by the 1934 Congress was the same as that reached by the FCC and the Fourth Circuit today: efficient operation of a national communications system precludes a reservation to the states of the power to fix depreciation in conflict with FCC depreciation prescriptions.

VI. When examined in light of the foregoing analysis, the remaining arguments of the states disintegrate.

The states present a number of arguments that do not survive review in light of the foregoing analysis. For example, the following interrelated arguments are stated in one form or another by the various states:

A. Arguments based on a narrow reading of the "interstate" concept in conflict with principles established by this Court. *See* for example Ohio (Petition at 10-14); Florida (Petition at 14.)

B. Arguments based on application of Subsections 2(b) and 221(b) of the Communications Act in conflict with the preemption doctrine applied by the courts.

C. Arguments based on the claim that the Congress in 1934 denied the FCC preemptive power with respect to depreciation.

D. Anxious hypotheticals -- arguing against possible further preemptive actions.

These arguments are illustrated where Louisiana (Jurisdictional Statement at 7-8, 19-20, 23-24, 27, 29), California (Petition at 2-3, 9, 12, 14-15) and Ohio (Petition at 2-3, 8-10, 12-14) cite and discuss Subsections 2(b) and 221(b) without even acknowledging judicial interpretation of these provisions. *See* notes 8 and 11, *supra*, and associated text. Similarly, Section 410 is cited by Louisiana (Jurisdictional Statement at 25-26) without

acknowledging the two Circuits that found in the history of this section indications of Congressional approval of FCC preemptive action. *See NARUC* v. *FCC*, 746 F.2d at 1500; *North Carolina I*, 537 F.2d at 795. And yet the notion that these same provisions of the statute prohibit FCC preemption of depreciation permeates the states' argumentation. *See* for example Ohio (Petition at 17), California (Petition at 12-15), Louisiana (Jurisdictional Statement at 23-27), Florida (Petition at 8-17, 19-21).

These states insist that the 1934 Congress decided against FCC preemptive power affecting depreciation; but their argument depends on ignoring inconvenient judicial construction of the statute and its legislative history under which the states' theory is untenable. The courts have rejected time and again the states' interpretation of Subsections 2(b) and 221(b) and Section 410. *See* notes 8 and 11, *supra*. The states' discredited interpretation of these provisions cannot support their arguments that these very provisions prohibit FCC preemption of depreciation -- particularly in the teeth of the expert agency's conclusion that Congress specifically intended FCC depreciation prescriptions to preempt inconsistent state action.

Having attempted to make the statute read as if the 1934 Congress had adopted the NARUC-sponsored version of Subsection 220(j), instead of rejecting it, the states then offer the unarguable proposition that it is for Congress to modify the Communications Act. *See* for example California (Petition at 14-16) and Ohio (Petition at 14). But no rewrite of the Act is necessary to support the FCC's action here -- an action that carries out those responsibilities specifically assigned by Congress in Subsection 220(b) and discharges those broad statutory responsibilities to act in the public interest stressed by the courts time and again.

In *Southwestern Cable*, 392 U.S. at 177, this Court quoted *Permian Basin*, 390 U.S. at 780:

> [W]e may not, "in the absence of compelling evidence that such was Congress' intention ... prohibit administrative action imperative for the achievement of an agency's ultimate purposes."

The Commission's action here was not only deemed by the Fourth Circuit and the FCC to be "imperative for the achievement of an agency's ultimate purpose"; it was also found by the expert agency to be specifically directed by Congress in order to give practical effect to one of the Commission's statutory assignments. *A fortiori*, then, the FCC's preemption is well within the agency's jurisdiction, and conflicting state action must yield to federal primacy.

The courts have interpreted the relevant terms of the Act numerous times in the last dozen years. No court has adopted the states' version of the jurisdictional scheme of the Act or accepted their various arguments dependent on that version.[27] As stressed recently by Judge Bork in rejecting still another state challenge to the established interpretation of the Communications Act:

> If the Act's goal of providing uniform, efficient service is ever to be realized, the Commission must be free to strike down the costly and inefficient burdens on interstate communications which are sometimes imposed by state regulation.

NARUC v. *FCC*, 746 F.2d at 1501. Impediments created by the states that " 'substantially affect' both the conduct and development of interstate communications" and that "infringe on the FCC's jurisdiction over interstate calls and offend the very purposes of the Communications Act which seeks to create a 'rapid, efficient, Nation-wide . . . communications service' " will be preempted. *Id.*

The states' refusal to recognize established legal standards governing FCC preemption leads to anxious hypotheticals —

27. Florida (Petition at 18-19) erroneously says the court in NARUC v. FCC, 533 F.2d 601 (D.C. Cir. 1976), applied Subsection 2(b). Of the three judges on the panel, only Judge Wilkey found Subsection 2(b) applicable. Judge Wright dissented, and Judge Lombard (concurring) found it unnecessary to reach the Subsection 2(b) question (at 622). Florida (Petition at 17-18) also claims to find support for its arguments in FCC v. Midwest Video Corp., 440 U.S. 689 (1979) -- a case that did not involve Subsections 2(b) and 221(b). The Court will strike down FCC action in conflict with limitations contained in the Act; but there is no such conflict between these provisions as construed by the courts and the FCC's preemption here.

preemptive actions that the states think the FCC might take some day. *See* for example Louisiana (Jurisdictional Statement at 22), Florida (Petition at 9-11), California (Petition at 9-12), Ohio (Petition at 7, 15-19); and *see* Maine (*amicus* brief at 2), arguing that the Commission's preemption is "tantamount to the reinstatement of the *Shreveport* doctrine. . . ."

But the preemptive action at issue here was carefully limited and based on a record and findings that justify that action by satisfying standards carefully articulated by the courts. The Commission's action bears no resemblance to what was at issue in the *Shreveport Rate Case*, where the Interstate Commerce Commission (ICC) required the adjustment of rates set by a Texas commission so as to prevent undercutting rates regulated by the ICC. *See* discussion in *North Carolina II*, 552 F.2d at 1047. There is no question here of action imposing an alignment of rates regulated by the states with those regulated by the federal agency. The FCC is merely doing what it was directed to do by Congress: prescribing depreciation methodology and rates. The ratemaking process is undisturbed at the state level except that, as Congress intended, the states may not deprive the FCC's depreciation prescriptions of practical effect.

The states' speculations about possible preemptive action in the future do not invalidate the limited preemption now under consideration. In any event, whatever future preemption occurs will be subjected to the same careful scrutiny and the same legal principles. The courts have *not* created a game without rules. The states' alarm results from their refusal to recognize the rules, *i.e.*, those limits established by the courts -- limits correctly applied in the case of depreciation preemption.

In summary, the arguments presented by the states seek to reargue points of law well settled in an FCC context. The states' consistent failure to recognize established law is testimony to their desperate position. When the states' claims are reviewed in light of established legal principles, these claims simply disintegrate, leaving no reason for plenary review by this Court.

CONCLUSION:

THE COURT SHOULD DENY REVIEW.

The carefully limited preemption here at issue comes squarely within the legal standards applied to FCC preemption by Circuit courts and by this Court. The states, refusing even to recognize these standards, have failed to meet the relevant tests. Further, as an implementation of explicit Congressional intent, the FCC's *1983 Preemption Order* should prevail.

Accordingly, the agency acted within the scope of its authority and rationally exercised its expert judgment when it concluded (a) that its depreciation policies and rates preempt inconsistent state depreciation policies and rates, and (b) that telephone plant used for both interstate and intrastate communication must be depreciated in accordance with FCC prescriptions.

There having been no showing that plenary consideration is justified, the Court should deny review.

Respectfully submitted,

RICHARD MCKENNA
One Stamford Forum
Stamford, Connecticut 06904
(203) 965-3078

Counsel of Record for GTE Service Corporation and its affiliated domestic telephone operating companies

Of Counsel:

WILLIAM R. MALONE
One Stamford Forum
Stamford, Connecticut 06904

JAMES R. HOBSON
1120 Connecticut Avenue, N.W.
Washington, D.C. 20036

March 18, 1985

APPENDIX 1

LISTING OF THE GTE COMPANIES IN COMPLIANCE WITH RULE 28.1

In compliance with the Court's Rule 28.1, following is a listing of the parent company and all subsidiaries or affiliates of GTE Service Corporation and its affiliated domestic telephone operating companies:

GTE CORPORATION
- GTE Service Corporation
- GTE Investment Management Corporation
- GTE Realty Corporation
  - City Center Hotel Corporation
  - GTE Realty Corporation of Connecticut
- GTE Shareholder Services Incorporated
- GTE Reinsurance Company Limited
- GTE Insurance Company Limited

- GTE SPRINT COMMUNICATIONS CORPORATION
  - GTE Sprint Communications Corporation of Virginia
  - GTE Sprint Redevelopment Corporation
  - Video Microwave, Inc.
- GTE SPACENET CORPORATION
- GTE SATELLITE CORPORATION
- GTE TELENET INCORPORATED
  - GTE Support Services Incorporated
  - GTE TELENET HOLDING CORPORATION
    - Cambridge Telecommunications Corporation
    - GTE Telenet Communications Corporation

- GTE PRODUCTS OF CONNECTICUT CORPORATION
  - GTE COMMUNICATIONS SYSTEMS CORPORATION
    - GTE Communication Systems-Asia Incorporated
    - GTE Telecomp de Juarez, S.A. de C.V.

GOVERNMENT SYSTEMS CORPORATION
- GTE International Systems Corporation
- GTE Microcircuits (Taiwan) Limited
- Syltec International Incorporated
- Sylvania Technical Systems, Inc.

GTE INTERNATIONAL INCORPORATED
- Advance Industries Argentina S.A.I.C.
- Automatic Electric do Brasil, S.A.
- Claude S.A.
  - Arlux S.A.
  - Claude Benelux S.A.
  - Societe B.A.G. et Compagnie
  - Societe B.A.G. S.A.R.L.
  - Societe des Etablissements Legourd et Compagnie
  - Societe des Etablissements Legourd S.A.R.L.
- Compania General de Telefonia y Electronica, S.A.
- GTE ATEA N.V. - S.A.
- GTE Australia Pty. Limited
  - GTE New Zealand Limited
- GTE Consumer Electronics AG
- GTE de Colombia S.A.
- GTE del Peru S.A.
- GTE do Brasil S.A. Industria e Comercio
  - Servi-Empire Assistencia Tecnica de Radio e Televisao S.A.
- GTE Electronica, S.A.
- GTE Export Corporation
  - GTE de Panama, S.A.
  - GTE International Incorporated Limitada
  - GTE Sylvania S.A. (Costa Rica)
  - GTE Sylvania S.A. de C.V. (El Salvador)
  - GTE Sylvania S.A. (Guatemala)
  - GTE Sylvania S.A. (Honduras)
  - GTE Sylvania S.A. (Nicaragua)
- GTE Far East (Services) Limited

- GTE Industries Incorporated
- GTE International Investment Company Ltd.
- GTE International Limited
- GTE Iran Incorporated
- GTE Overseas Corporation
- GTE Precision Materials (France)
- GTE Sistemas de Informacao Ltda.
- GTE S.A.
- GTE Sylvania AB (Sweden)
- G.T.E. Sylvania, Greek Commercial Corporation for Electric Lamps
- GTE Sylvania A/S (Denmark)
- GTE Sylvania A/S (Norway)
- GTE Sylvania N.V. (Belgium)
- GTE Sylvania S.A. (Switzerland)
- GTE Sylvania, S.A. de C.V. (Mexico)
- GTE Sylvania S.A.R.L. (France)
- GTE Sylvania S.A. Electronica, Quimica, Industrial y Comercial (Argentina)
- GTE Sylvania Canada Limited
  - CEB Limited
  - Electrolier Corporation
  - G.T.E. Sylvania Canada Corporation
  - Iberville Fittings Limited
    - Cenal Foundry Ltd.
- GTE Sylvania Gesellschaft m.b.H.
- GTE Sylvania Licht GmbH
- GTE Sylvania Limited (Hong Kong)
- GTE Sylvania (UK) Limited
  - Endura Viking Lamps Limited
  - GTE Products (UK) Limited
  - GTE Sylvania Limited (England)
  - GTE Sylvania (GB) Limited
  - GTE Unistrut Limited
- GTE Taiwan Telecommunications Ltd.

GTE Telecommunications Incorporated
GTE Telecomunicazioni S.p.A.
Kondo Sylvania Limited
Radiac Corporation
S.A. GTE
Sylvania Electronica Limitada
The Microexchange Corporation
Zinsco de Venezuela, C.A.

GTE PRODUCTS CORPORATION
Chace Precision Materials Corporation
Chace Specialty Metals, Inc.
Colonial Merchandising Corporation
Commonwealth Manufacturing Corporation
Gibson Electric of Puerto Rico, Inc.
GTE Leasing Corporation
Kalama Grain Terminal, Inc.
GTE Sylvania Wiring Devices Incorporated
GTE Transport Incorporated
GTE Unistrut (Europa) B. V.
Lamparas Especiales de Mexico, S.A. de C.V.
Syltron, Inc.
Sylvania Componentes Electronicos, S.A.
Sylvania Connector Products, Inc.
Sylvania Lighting Company
Sylvania Lighting Services Corp.
Sylvania Overseas Trading Corporation
Sylvania Realty Corporation
Sylvania Special Products, Inc.
Televac, Inc.
West Indies Realty Company

GTE VALERON CORPORATION
Valenite-Modco (Australia) Pty. Limited
Valenite-Modco S.A.
Valenite-Industria e Comercio, Ltda.

Valenite-Modco Limited
Valeron Limited
Valdiamant AB
Valenite-Modco SARL
Valdiamant International GmbH
Valenite-Modco S.p.A.
Valenite-Modco International, Inc.
Nippon Valenite-Modco K.K.
Valenite-Modco (Proprietary) Limited
Valenite-Modco (U.K.) Limited
Valeron-Modco Pacific Co., Ltd.
Valenite-Modco Caribe, Inc.
Valeron International, Inc.
Valeron-Europe, Ltd.
Valeron-Modco PTE, Ltd.
GTE LABORATORIES INCORPORATED
GTE FINANCE N.V.
GTE Export Factoring Company B.V.

GENERAL TELEPHONE COMPANY OF CALIFORNIA
GENERAL TELEPHONE COMPANY OF FLORIDA
GENERAL TELEPHONE COMPANY OF KENTUCKY
GENERAL TELEPHONE COMPANY OF THE SOUTHEAST
GENERAL TELEPHONE COMPANY OF THE SOUTHWEST
HAWAIIAN TELEPHONE COMPANY
The Micronesian Telecommunications Corporation
BETHEL AND MT. AETNA TELEPHONE AND TELEGRAPH COMPANY
GARRETT TELEPHONE CO., INC.
GENERAL TELEPHONE COMPANY OF ILLINOIS
GENERAL TELEPHONE COMPANY OF INDIANA, INC.

Appendix 1

GENERAL TELEPHONE COMPANY OF MICHIGAN
GENERAL TELEPHONE COMPANY OF THE MIDWEST
GENERAL TELEPHONE COMPANY OF OHIO
GENERAL TELEPHONE COMPANY OF PENNSYLVANIA
GENERAL TELEPHONE COMPANY OF WISCONSIN
GTW Telephone Systems Incorporated
GENERAL TELEPHONE COMPANY OF ALASKA
GENERAL TELEPHONE COMPANY OF THE NORTHWEST, INC.
West Coast Telephone Company of California

Appendix 2

EXCERPTS FROM THE RECORD OF THE FCC'S CC DOCKET NO. 79-105

FIRST EXCERPT

From Petition for Declaratory Ruling of General Telephone Company of Ohio filed June 7, 1982, pages 6-7 and Exhibit "E":

> 11. The use of different depreciation rates for the interstate portion of General's plant accounts than for the intrastate portion will not achieve one hundred percent capital recovery, except by sheer and remote chance, even if the "books" for each jurisdiction reflect full capital recovery. The reason for this is that jurisdictional allocation factors are continually changing. Attached hereto as Exhibit E is an analysis illustrating this fact. Moreover, in this situation there continues to exist a possibility of "stranded investment" -- i.e., a residue of investment dollars remaining in rate base long after retirement of the related asset. In fact, "stranded investment" may remain in rate base in perpetuity if a remaining life adjustment is never made. In Docket No. 20188 this Commission sought to avoid "stranded investment." *See* 83 FCC 2d at 288, 289.

EXHIBIT "E"

THE EFFECT OF DIFFERENT JURISDICTIONAL D̶EPRECIATION RATES IN THE PRESENCE OF CHANGING JURISDICTIONAL ALLOCATION FACTORS IS TO PREVENT 100% CAPITAL RECOVERY

The attached examples show that the use of different depreciation methodologies for the interstate and intrastate portions of General's plant accounts will not achieve the objective of one hundred percent capital recovery -- no more and no less -- except by sheer and remote chance. This is because jurisdictional allocation factors are based on changing usage studies (of both holding times and message volumes) and are revised monthly. Investment and expenses, including depreciation, allocated to interstate and intrastate services, change monthly for purposes of jurisdictional separations and settlements as a result of usage changes. The use of different depreciation rates for interstate and intrastate purposes will mean either (i) that General will *never realize* full capital recovery, or (ii) General will realize an *over-recovery*. In either case, the ratepayer will be disserved.

To illustrate the effect of changing jurisdictional allocation factors, Schedule E-1 and Schedule E-2 set forth a Single Asset Example with two variations in the separations factors over four years.

As shown in Schedule E-1, on an original investment of $100, General would recover only $98.75, resulting in failure *ever* to recover $1.25, constituting 1.25% of the original investment -- even though both the interstate and intrastate "books" would indicate full capital recovery.

Conversely, as shown in Schedule E-2, on an original investment of $100, General would recover $101, for a $1 over-recovery, even though both sets of "books" would indicate nothing more than full capital recovery.

These illustrations are intended to frame the problem in simplified, understandable terms. The conflict between FCC prescriptions of depreciation methodologies and rates and state determinations must necessarily result in destroying any assurance that the depreciation process will be allowed to work as intended, providing recovery of just the amount invested, not more, not less.

* * * * *

SECOND EXCERPT

From Joint Petition for Clarification filed June 8, 1982 of GTE Service Corporation and its affiliated domestic telephone companies; United Telephone System, Inc., on behalf of the companies comprising the United Telephone System; and Continental Telecom Inc., on behalf of its telephone operating companies; at 17-18:

> As reflected in the GTE Ohio company's petition, there is a differential between federal and state prescriptions exceeding $7 million in depreciation charges for the first year of rate implementation. Not only does this mean that our Ohio company will not realize timely capital recovery, as the FCC intended in adopting its Docket 20188 policies and in issuing its prescriptive decisions under § 220(b) of the Act; it could mean that the Ohio company, caught between federal and state sovereigns, may be denied full recovery of invested capital. Either of these results would frustrate the Commission's policies adopted to implement its statutory mandate, and would violate the basic principles of equity and fairness which have governed federal/state regulation of carriers involved in providing both interstate and intrastate service. [Footnote citing *Smith* v. *Illinois Bell Tel. Co., supra.*]
>
> As a practical matter, the same piece of property cannot be depreciated successfully at two different rates. Under modern accounting methods, units of equipment are

placed in groups. The costs represented by these groups are then allocated between interstate and intrastate jurisdictions. These allocations may change month to month, depending on measured jurisdictional use of the property in question. Given these circumstances, it is virtually inevitable that capital will be recovered more slowly or more quickly than one rate or the other calls for. If the intrastate ratepayer contributes too much, the interstate customer will give too little, and *vice versa*.

This impossibility of successful depreciation -- that is, recovery of exactly the capital invested except by sheer coincidence -- suggests that dual depreciation rates are not feasible and that a single rate should be used. If the Commission believes that the rates it approves, based on carefully-developed federal policies and rules, should be the prevailing ones, it has the legal power to accomplish this.[16]

* * * * *

16. In the *North Carolina* cases cited in ¶37 of the Reconsideration Order, and in the *Computer II* decision of the FCC, 84 F.C.C.2d 50, 104, the essential indivisibility of the interstate and intrastate uses of telephone equipment was crucial to the legal outcome. Similarly here, despite the artificial attribution of property to intrastate and interstate jurisdictions, depreciation necessarily is a unitary process. The property cannot be divided successfully.

APPENDIX 3

RELEVANT PROVISIONS OF THE INTERSTATE COMMERCE ACT AS OF 1934

To the extent relevant, following are the provisions of Section 20 of the Interstate Commerce Act as they were in 1934:

* * * * *

(5) The Commission may, in its discretion, prescribe the forms of any and all accounts, records, and memoranda to be kept by carriers subject to the provisions of this Act, including the accounts, records, and memoranda of the movement of traffic, as well as of the receipts and expenditures of moneys. The Commission shall, as soon as practicable, prescribe, for carriers subject to this Act, the classes of property for which depreciation charges may properly be included under operating expenses, and the percentages of depreciation which shall be charged with respect to each of such classes of property, classifying the carriers as it may deem proper for this purpose. The Commission may, when it deems necessary, modify the classes and percentages so prescribed. The carriers subject to this Act shall not charge to operating expenses any depreciation charges on classes of property other than those prescribed by the Commission, or charge with respect to any class of property a percentage of depreciation other than that prescribed therefor by the Commission. No such carrier shall in any case include in any form under its operating or other expenses any depreciation or other charge or expenditure included elsewhere as a depreciation charge or otherwise under its operating or other expenses. The Commission shall at all times have access to all accounts, records, and memoranda, including all documents, papers and correspondence now or hereafter existing, and kept or required to be kept by carriers subject to this Act, and the provisions of this section respecting the preservation and destruction of books, papers, and documents shall apply thereto, and it shall be unlawful for such carriers to keep any other accounts, records, or memoranda than those prescribed or approved by the Commission, and it may

employ special agents or examiners, who shall have authority under the order of the Commission to inspect and examine any and all accounts, records, and memoranda, including all documents, papers, and correspondence now or hereafter existing, and kept or required to be kept by such carriers. This provision shall apply to receivers of carriers and operating trustees. The provisions of this section shall also apply to all accounts, records, and memoranda, including all documents, papers, and correspondence now or hereafter existing, kept during the period of Federal control, and placed by the President in the custody of carriers subject to this Act.

* * * * *

(6) In case of failure or refusal on the part of any such carrier, receiver, or trustee to keep such accounts, records, and memoranda on the books and in the manner prescribed by the Commission, or to submit such accounts, records, and memoranda as are kept to the inspection of the Commission or any of its authorized agents or examiners, such carrier, receiver, or trustee shall forfeit to the United States the sum of five hundred dollars for each such offense and for each and every day of the continuance of such offense, such forfeitures to be recoverable in the same manner as other forfeitures provided for in this Act.

(7) Any person who shall willfully make any false entry in the accounts of any book of accounts or in any record or memoranda kept by a carrier, or who shall willfully destroy, mutilate, alter, or by any other means or device falsify the record of any such account, record, or memoranda, or who shall willfully neglect or fail to make full, true, and correct entries in such accounts, records, or memoranda of all facts and transactions appertaining to the carrier's business or shall keep any other accounts, records, or memoranda than those precribed or approved by the Commission, shall be deemed guilty of a misdemeanor and shall be subject, upon conviction in any court of the United States of competent jurisdiction to a fine of not less than one thousand dollars nor more than five

thousand dollars or imprisonment for a term not less than one year nor more than three years, or both such fine and imprisonment: *Provided*, That the Commission may in its discretion issue orders specifying such operating, accounting, or financial papers, records, books, blanks, tickets, stubs, or documents of carriers which may, after a reasonable time, be destroyed, and prescribing the length of time, such books, papers, or documents shall be preserved.

APPENDIX 4

TEXT OF SECTION 220 OF THE COMMUNICATION ACT OF 1934*, 47 U.S.C. § 220

§ 220. **Accounts, records, and memoranda; depreciation charges; forfeitures and penalties**

(a) The Commission may, in its discretion, prescribe the forms of any and all accounts, records, and memoranda to be kept by carriers subject to this chapter, including the accounts, records, and memoranda of the movement of traffic, as well as of the receipts and expenditures of moneys.

(b) The Commission shall, as soon as practicable, prescribe for such carriers the classes of property for which depreciation charges may be properly included under operating expenses, and the percentages of depreciation which shall be charged with respect to each of such classes of property, classifying the carriers as it may deem proper for this purpose. The Commission may, when it deems necessary, modify the classes and percentages so prescribed. Such carriers shall not, after the Commission has prescribed the classes of property for which depreciation charges may be included, charge to operating expenses any depreciation charges on classes of property other than those prescribed by the Commission, or, after the Commission has prescribed percentages of depreciation, charge with respect to any class of property a percentage of depreciation other than that prescribed therefor by the Commission. No such carrier shall in any case include in any form under its operating or other expenses any depreciation or other charge or expenditure included elsewhere as a depreciation charge or otherwise under its operating or other expenses.

(c) The Commission shall at all times have access to and the right of inspection and examination of all accounts, records, and memoranda, including all documents, papers, and correspondence now or hereafter existing, and kept or required to be kept by such carriers, and the provisions of this section respecting the

* Section 220 has not been amended since 1934.

preservation and destruction of books, papers, and documents shall apply thereto. The burden of proof to justify every accounting entry questioned by the Commission shall be on the person making, authorizing, or requiring such entry and the Commission may suspend a charge or credit pending submission of proof by such person. Any provision of law prohibiting the disclosure of the contents of messages or communications shall not be deemed to prohibit the disclosure of any matter in accordance with the provisions of this section.

(d) In case of failure or refusal on the part of any such carrier to keep such accounts, records, and memoranda on the books and in the manner prescribed by the Commission, or to submit such accounts, records, memoranda, documents, papers, and correspondence as are kept to the inspection of the Commission or any of its authorized agents, such carrier shall forfeit to the United States the sum of $500 for each day of the continuance of each such offense.

(e) Any person who shall willfully make any false entry in the accounts of any book of accounts or in any record or memoranda kept by any such carrier, or who shall willfully destroy, mutilate, alter, or by any other means or device falsify any such account, record, or memoranda, or who shall willfully neglect or fail to make full, true, and correct entries in such accounts, records, or memoranda of all facts and transactions appertaining to the business of the carrier, shall be deemed guilty of a misdemeanor, and shall be subject, upon conviction, to a fine of not less than $1,000 nor more than $5,000 or imprisonment for a term of not less than one year nor more than three years, or both such fine and imprisonment: *Provided*, That the Commission may in its discretion issue orders specifying such operating, accounting, or financial papers, records, books, blanks, or documents which may, after a reasonable time, be destroyed, and prescribing the length of time such books, papers, or documents shall be preserved.

(f) No member, officer, or employee of the Commission shall divulge any fact or information which may come to his knowledge during the course of examination of books or other accounts, as hereinbefore provided, except insofar as he may be directed by the Commission or by a court.

(g) After the Commission has prescribed the forms and manner of keeping of accounts, records, and memoranda to be kept by any person as herein provided, it shall be unlawful for such person to keep any other accounts, records, or memoranda than those so prescribed or such as may be approved by the Commission or to keep the accounts in any other manner than that prescribed or approved by the Commission. Notice of alterations by the Commission in the required manner or form of keeping accounts shall be given to such persons by the Commission at least six months before the same are to take effect.

(h) The Commission may classify carriers subject to this chapter and prescribe different requirements under this section for different classes of carriers, and may, if it deems such action consistent with the public interest, except the carriers of any particular class or classes in any State from any of the requirements under this section in cases where such carriers are subject to State commission regulation with respect to matters to which this section relates.

(i) The Commission, before prescribing any requirements as to accounts, records, or memoranda, shall notify each State commission having jurisdiction with respect to any carrier involved, and shall give reasonable opportunity to each such commission to present its views, and shall receive and consider such views and recommendations.

(j) The Commission shall investigate and report to Congress as to the need for legislation to define further or harmonize the powers of the Commission and of State commissions with respect to matters to which this section relates.

(7)

No. 84-889

IN THE

Supreme Court of the United States

October Term, 1984

PEOPLE OF THE STATE OF CALIFORNIA and THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA, *et al.*,

Petitioners,

vs.

FEDERAL COMMUNICATIONS COMMISSION and UNITED STATES OF AMERICA,

Respondents.

REPLY TO MOTIONS TO DISMISS AND BRIEFS IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

JANICE E. KERR*
General Counsel
J. CALVIN SIMPSON
Assistant General Counsel
GRETCHEN DUMAS
Principal Counsel
PEOPLE OF THE STATE OF CALIFORNIA AND THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA
350 McAllister Street
San Francisco, California 94102
* *Counsel of Record*
Telephone: (415) 557-0470

DAVID E. BLABEY
Counsel
LAWRENCE G. MALONE
Assistant Counsel
DEPARTMENT OF PUBLIC SERVICE OF THE STATE OF NEW YORK
Three Empire State Plaza
Albany, New York 12223

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Batavia, N.Y. (716) 344-2000

22 P/O

FRANK J. KELLEY
Attorney General
LOUIS J. CARUSO
Solicitor General
DON L. KESKEY
LEO H. FRIEDMAN
Assistant Attorney General
THE STATE OF MICHIGAN AND
MICHIGAN PUBLIC SERVICE
COMMISSION
1000 Long Boulevard, Suite 11
Lansing, Michigan 48910
LYNDA S. MOUNTS
CADWALADER, WICKERSHAM & TAFT
1333 New Hampshire Avenue, N.W.
Washington, D.C. 20036
Of Counsel

WILLIAM PAUL RODGERS, JR.
General Counsel
CHARLES D. GRAY
Assistant General Counsel
GENEVIEVE MORELLI
Deputy Assistant
General Counsel
NATIONAL ASSOCIATION OF
REGULATORY UTILITY
COMMISSIONERS
1102 ICC Building
Post Office Box 684
Washington, D.C. 20044

JOEL B. SHIFMAN
Attorney
PUBLIC SERVICE COMMISSION
OF WEST VIRGINIA
201 Brook Street
Post Office Box 812
Charleston, West Virginia 25323

JACK SHREVE, President
NASUCA and Public Counsel
STATE OF FLORIDA
OFFICE OF THE PUBLIC COUNSEL
Room 4, Holland Building
Tallahassee, Florida 32301
BENJAMIN H. DICKENS, JR. ESQ.
CITIZENS OF THE STATE
OF FLORIDA
OFFICE OF PUBLIC COUNSEL
Room 4, Holland Building
Tallahassee, Florida 32301

STEVEN W. HAMM
Consumer Advocate for the
State of South Carolina
RAYMOND E. LARK, JR.
Assistant Consumer Advocate
SOUTH CAROLINA DEPARTMENT
OF CONSUMERS AFFAIRS
2801 Devine Street
Columbia, South Carolina 29250

CHRISTOPHER K. SANDBURG
Special Assistant
Attorney General
MINNESOTA DEPARTMENT OF
PUBLIC SERVICE
1102 Bremer Tower
7th & Minnesota
St. Paul, Minnesota 55101

DAVID LYNCH
Assistant General Counsel
IOWA STATE COMMERCE
COMMISSION
1350 New York Avenue, N.W.,
No. 1023
Washington, D.C. 20008

BRIAN MOLINE
General Counsel
JAMES FLAHERTY
Attorney
KANSAS STATE CORPORATION COMMISSION
State Office Building
Topeka, Kansas 66612

HOWARD C. DAVENPORT
General Counsel
LLOYD N. MOORE, JR.
MOORE & HICKS
1250 Eye Street, N.W.,
No. 201
Washington, D.C. 20005
Attorneys for Public Service Commission of the District of Columbia

STEVEN SCHUR
Chief Counsel
JON KINGSTAD
Assistant Chief Counsel
WISCONSIN PUBLIC SERVICE COMMISSION
Post Office Box 7854
Madison, Wisconsin 53707

ROBERT WALDRUM
Attorney
ARKANSAS PUBLIC SERVICE COMMISSION
1000 Center
P.O. Box C-400
Little Rock, Arkansas 72202

KENNETH O. EIKENBERRY
Attorney General
LARRY V. ROGERS
Assistant Attorney General
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION
Highways-Licenses Building
Olympia, Washington 98504

IRWIN I. KIMMELMAN
Attorney General of
New Jersey
By ALAN S. PRALGEVER
Deputy Attorney General
for the New Jersey Board of Public Utilities
Division of Law
1100 Raymond Boulevard, No. 316
Newark, New Jersey 07102

JOSEPH I. LIBERMAN
Attorney General
WILLIAM B. GUNDLING
Assistant Attorney General
DEPARTMENT OF PUBLIC UTILITY CONTROL/STATE OF CONNECTICUT
1 Central Park Plaza
New Britain, Connecticut 06051

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IN THE

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October Term, 1984

No. 84-889

PEOPLE OF THE STATE OF CALIFORNIA and THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA, *et al.*,
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vs.

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Respondents.

REPLY TO MOTIONS TO DISMISS AND BRIEFS IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

Preliminary Statement

On December 22, 1982, the Federal Communications Commission (FCC) broke with 50 years of tradition and declared that state regulatory agencies were preempted from ordering depreciation practices which were inconsistent with the methods prescribed by the FCC. *Matter of Amendment of Page 31,* 48 Fed. Reg. 2324 (January 18, 1983). The Commission based its preemption order on two grounds:

(1) Congress had mandated (in the 1934 Communications Act, 47 U.S.C. 220(b)) that it set depreciation for *intrastate* ratemaking purposes; and

(2) Preemption was, in any event, necessary to implement the FCC's policy of promoting competition in the telecommunications industry.[1]

On January 18, 1984, the Court of Appeals for the Fourth Circuit affirmed the FCC's decision by a 2-1 vote. The majority did not address whether the 1934 Communications Act allowed the FCC to set depreciation rates for intrastate ratemaking purposes but nonetheless upheld preemption on the ground that a federal policy would be frustrated. *Virginia State Corporation Commission v. FCC, et al.*, 737 F.2d 388, (4th Cir., 1984).

Respondents' attempt to prevent this Court's review of the vital and far-reaching questions raised by the lower court's decision by arguing that the Fourth Circuit should be upheld on a rationale it refused to embrace; that is, that the Communications Act preempted state regulatory agencies from developing their own depreciation methods for intrastate ratemaking purposes.

[1] The issue in *this* case is not the propriety of ELG depreciation or the promotion of competition in the telecommunications industry, which many states instituted well before the FCC. [See *Public Service Commission of Wisconsin v. Federal Communications Commission,* Case No. 85-1258 (7th Cir. 1985) which is currently challenging the propriety of ELG.] The actual question for review is whether the FCC can preempt the states on an essential component of intrastate ratemaking.

Our original petition challenged the rationale the Fourth Circuit actually used to preempt. This reply brief will demonstrate (1) the Commission was correct in the *first* 50 years of its history when it read the Communications Act to permit the states to develop depreciation methods for intrastate ratemaking purposes; and (2) there is absolutely no relevant judicial precedent in support of the FCC's erroneous order.

Summary of Argument

The respondents offer three arguments to support their claim that Section 220(b) of the Communications Act authorizes the FCC to preempt intrastate depreciation ratemaking. They are:

(1) Section 220(b)'s predecessor (Interstate Commerce Act Section 20(5)) empowered the ICC to preempt the states' setting of depreciation rates.

This argument is incorrect because while the ICC defended its potential jurisdiction by suggesting that Section 20(5) authorized it to preempt, it never even attempted to do so. In fact, it emphasized that "the great bulk of telephone business is of strictly local concern, and the state commissions are much better informed and equipped than we are to pass upon the conditions surrounding the local service ...". *Depreciation Charges of Telephone Companies,* 118 ICC 295, 374 (1926).

(2) Congress in 1934 refused to retract the ICC's preemptive authority when it rejected a proposed Section 220(j) to the Communications Act which would have expressly prohibited preemption.

This argument is incorrect because the Senate replaced Section 220(j) with Section 152(b)(1), which accomplished the same purpose.

(3) Sections 220(h) and (i) which allow the Commission to excuse compliance with its depreciation orders and require the FCC to consider the "views and recommendations" of the states

before altering depreciation requirements reflect a congressional intent to delegate preemptive powers to the FCC.

This argument is incorrect because the Federal Government in 1934 had neither the resources nor the experience to set depreciation rates for *interstate* plant (78 Cong. Rec. S.4139 (Daily Ed. March 10, 1934)), and therefore Congress directed it §220(i) to rely on the states in setting *interstate* depreciation rates, and, when necessary, to defer to state depreciation ratemaking even for interstate plant (§220(h)). If there is any doubt that the respondents have totally mischaracterized Congress's intent in enacting these provisions, we ask the Court to review the House's original version of the Communication's Act which included Section 220(i) with the original Section 220(j) which explicitly *prohibited* preemption.

The Courts have long recognized that the Communications Act, particularly Section 152(b)(1), preserves the states' exclusive jurisdiction of "charges, classifications, practices, services, facilities, or regulations" relating to intrastate communications. *North Carolina Utilities Commission v. FCC,* 537 F.2d 787 (4th Cir. 1976), *cert. denied* 429 U.S. 1027 (1976). Nonetheless, the respondents in this case, while conceding that nearly all intrastate plant is used also for interstate functions, claim that Section 152(b)(1) protects only the states' jurisdiction of intrastate plant which is not jointly used. This interpretation defies all relevant precedent, the plain language of Section 152(b)(1) and Congress's explicit intent in enacting the Communications Act. Indeed, if adopted by the Court, the respondents' position would render the primary basis for the states' original support of the Communications Act (§152(b)) meaningless.

I. The Plain Language Of Section 220(b) Makes Absolutely No Reference To Intrastate Facilities And Therefore Offers No Evidence Of A Congressional Intent To Preempt State Depreciation Methods Relating Solely To Intrastate Communications.

A. Section 220(b)'s Legislative History Defies The FCC's Claim That It Preempts The State's Development Of Depreciation Methods For Intrastate Plant.

1. Interstate Commerce Act §20(5).

Congress created the Interstate Commerce Commission in 1887 to regulate the interstate transportation of persons or property by rail, road or water. The ICC's jurisdiction was extended to telephone companies in 1910 but, hardpressed by the public demand for railroad reform, the Commission spent little or no time regulating the telephone industry. In fact, since nearly all telephone service was intrastate, all telephone regulation was essentially conducted by the states. 78 Cong. Rec. S.4139 (Daily Ed. Mar. 10, 1934).

With the end of World War I and the termination of federal control of the railroads, Congress enacted the Transportation Act of 1920 which empowered the ICC to set *fixed* interstate rates for the first time. 41 Stat. 485 (1920); *see* Sharfman, *The Interstate Commerce Act,* 197, n.38 (1931). While several sections of the Transportation Act expressly preempted state regulation (*e.g.,* Section 20(a)(7) regarding securities; Section 13(4) concerning discriminatory pricing) the provisions relating to depreciation did not do so. In fact, they made absolutely no reference to intrastate plant or facilities (Section 20(5)).

Indeed, when the ICC was asked to preempt the states and set depreciation methods for intrastate telephone plant, it deferred to the states' expertise, emphasizing that "the great bulk of telephone business is of a strictly local concern, and the state Commissions are much better informed and equipped than we are to pass upon

the conditions surrounding the local service ...". *Depreciation Charges of Telephone Companies,* 118 ICC 295, 374 (1926). It, therefore, directed telephone companies to file proposed depreciation rates not with the ICC but with state regulatory agencies.

2. Communications Act §220(b).

It was against this background, and the public demand for reform of radio broadcast regulation, that Congress in 1934 created the Federal Communications Commission. Approximately 75% of the Communications Act represented a *verbatim* transposition of either the 1927 Radio Act or the Interstate Commerce Act (ICA). See, *Sloan,* Vol. 5 *American Landmark Legislation,* 417, 512 (1977). However, at the insistence of state regulators, specific sections were added to the Act "to safeguard state regulation". 78 Cong. Rec. S. 8882 (Daily Ed. May 15, 1934). Most notably, Section 152(b) was enacted to preserve the states' jurisdiction over intrastate facilities, rates, classifications and services.

B. The Respondents' Reading Of The Communications Act's Statutory Scheme Is Illogical.

Lacking the slightest evidentiary basis in Section 220(b) for their position that the states may not set intrastate depreciation rates, the respondents attempt to weave a thread of preemption with provisions relating to (1) the FCC's ability to excuse compliance with its depreciation and accounting orders (Section 220(h)); and (2) its obligation to notify state Commissions of proposed actions regarding "accounts, records or memoranda" (Section 220(i)) (FCC, 13-14, n.18). In fact, these provisions were enacted to facilitate state guidance in setting *interstate* depreciation charges.

The FCC from its outset has been responsible for the regulation of broadcasting, telegraph and telephone communications. A review of the FCC's annual reports in its early years shows that it was extremely small and, by

its own admission, totally lacked the expertise to set depreciation rates for the telecommunications industry.

As Senator Dill repeatedly stressed, the Federal government in 1934 had no experience in regulating telephone companies:

> The Interstate Commerce Commission has been so busy regulating the railroads that they have not had time to give real consideration to the problems in connection with rate regulation of telephones and telegraphs. It is only in recent years that the communications business has been big enough to demand the attention of those who use it from the standpoint of giving rate regulation. 78 Cong. Rec. S.4139 (Daily Ed. March 10, 1934).

Thus, in directing the FCC to begin setting depreciation rates for *interstate* plant, Congress cautioned the Commission to rely heavily on state regulatory expertise[2]—which it did. 47 U.S.C. §220(i).[3] Moreover, if the Commission was unable to fulfill this responsibility, Section 220(h) allowed it to defer *all* depreciation ratemaking to the states.

The respondents also attempt to draw support for their erroneous reading of Section 220(b) from the Senate's failure to enact the originally proposed Section 220(j). But that analysis ignores the fact that at the same time the Senate modified Section 220(j), as originally proposed by the states, it added Section 152(b)(1) which contained an even broader statement of the preservation of state

[2] It is therefore understandable that the FCC's Annual Reports emphasized the Commission's dependence on the states in setting *interstate* charges. *E.g.*, 1938 FCC Ann. Rep. 32; 1940 FCC Ann. Rep. 34.

[3] If there is any doubt that Section 220(i) did not assume preemption, it should be settled by the fact that the House's original version of the Communications Act included both Section 220(i) and Section 220(j) which explicitly reserved intrastate depreciation for the states. A *fortiori* Section 220(i) cannot be read to assume preemption when accompanied by Section 152(b)(1) (discussed *infra*) which explicitly reserved jurisdiction over *all* intrastate charges, classifications, practices to the states.

authority over intrastate telecommunications. See Hearings on S.2910, 73rd Cong. 2d Sess., pp. 1-2, 12; S. Rep. No. 781, 73rd Cong. 2d Sess. 3, 5 (1934).

During the course of Congressional hearings the states made it clear that they did not insist on the need for the specific language of their proposed Section 220(j). Rather, all they asked was

> for language which will leave the State commissions unhampered as to allowances to be made for depreciation in cases involving intrastate rates. *Hearings on H.R. 8301*, 73d, Cong., 2d Sess. 143 (1934), (Testimony of John Benton, NARUC General Solicitor).

The language of Section 152(b)(1) accomplished that goal, thus leading the states ultimately to support passage of the Act.

C. Respondents' Position that Section 220(b) "Explicitly Directed" The FCC To Preempt State Depreciation Ratemaking Is Belied By 50 Years Of FCC Practice.

The respondents claim that Section 220(b) is an "explicit direction of Congress" for the FCC to preempt the states from developing their own depreciation methods for intrastate ratemaking purposes (GTE, 4). Of course, their argument is belied by the FCC's actions for nearly 50 years when it made absolutely no attempt to set depreciation rates for intrastate facilities and acquiesced in the states' setting of inconsistent intrastate depreciation rates. (See California Petition, fn. 9.) In fact, as indicated, *supra*, the FCC not only limited its depreciation ratemaking to interstate plant (and so informed Congress) (*e.g.* 1940 FCC ANN. REP., 34), but it consistently read Section 220(b) as *not* authorizing its preemption of the states' depreciation practices. As the Commission indicated in its April 7, 1982 order:

> Telephone companies have rarely challenged past state commission departures from accounting or depreciation rules prescribed by this Commission. Such challenges have *not* been successful. . . . Thus,

AT&T and GTE are asking us to repudiate nearly 40 years of administrative practice and applicable state court precedent by adopting the interpretation of Section 220 that would require an unwilling state commission to follow all depreciation and accounting methods prescribed by this commission (Emphasis added). (California Appendix, pgs. A.46-A.47.)

The FCC's *current* position that Section 220(b) *unequivocally* directed it to preempt the states' *intrastate* depreciation classifications exceeds the bounds of reasonable argument.

II. All Relevant Judicial Precedent Recognizes The States' Exclusive Authority To Determine The Intrastate Rate Treatment Of Intrastate Facilities.

Respondents' second line of attack is that the states' authority to set rates under Section 152(b) has already been abrogated by existing case law. Such an assertion could not be further from the truth.

No prior case has directly reviewed whether Section 152(b) reserves to the states sole control over the setting of rates for intrastate service, including the setting of the elements (depreciation charges) that make up these rates. The cases cited by respondents raise fundamentally different issues and if anything support the petitioners' position in this case. In fact, the court's opinion below, rather than following the cited line of cases, contradicts its own earlier teaching in this area.

The Fourth Circuit's decision ignored its own dicta in *NCUC I* which acknowledged and explained the authority of the states as follows:

> "We have no doubt that the provisions of section 2(b) [47 U.S.C. 152(b)1] deprive the [Federal Communications] Commission of regulatory power over local services, facilities and disputes that in their nature and effect are separable from and do not substantially affect the conduct or development of interstate communications ... [R]atemaking typifies those activities of the telephone industry which lend themselves to *practical separation* of the local from the interstate in such a way that local regulation of one does not interfere with national regulation of the other." *NCUC I, supra,* at 793. (emphasis added).

Under the two part test found in this language the FCC cannot preempt unless a state's regulation of intrastate service is (1) inseparable from interstate services, *and* (2) substantially affects the conduct or development of interstate communications.

The inseparability test covered the facts in *NCUC I,* since interconnection of CPE cannot be separated between intrastate and interstate uses. However, it does not extend to depreciation ratemaking which, as evidenced by the FCC's practices since 1934 and acknowledged by the Court below (See 737 F.2d at 396), can be "separated".

In *Computer and Communications Association v. FCC,* 693 F.2d at 215 (*Computer II*) the D.C. Circuit relying on the *NCUC I* tests affirmed the FCC's preemption of all authority over CPE. Just as in *NCUC I,* it was clear that the service in Computer II, provision of CPE, was jurisdictionally inseparable and there was no way other (than through preemption) for the FCC to exercise "its direct authority to determine the regulatory treatment of CPE used for interstate communications." *Computer II, supra* at 215.

In the Fourth Circuit decision at issue the court considered the two parts of the *NCUC I* test in determining whether to affirm FCC preemption of depreciation authority over intrastate service, but made a radical departure from prior cases by treating the two tests as in the alternative and basing its decision *solely* on a "substantial effects" test.[4] The Fourth Circuit by

[4] As pointed out in our initial brief, the FCC readily conceded nine months before rendering its preemption order that no federal purpose was frustrated by the *states'* development of depreciation rates.

abandoning the inseparability test overruled its own prior decisions (*NCUC I* and *North Carolina Utilities Commission v. FCC*, 552 F.2d 1036 (4th Cir., 1977), *cert. denied*, 434 U.S. 876 (1977) (*NCUC II*)) (NCUC II followed the holding of *NCUC I*) and created a conflict with the D.C. Circuit.[5]

Further, the FCC has failed to meet even the second part of the test, that the state prescription of depreciation rates will substantially affect the conduct and development of interstate communications. See California Petition, pgs. 9-12. Therefore, respondents' reliance on this line of cases as dispositive of the issues raised in the Fourth Circuit's decision is misplaced and should be disregarded.

Conclusion

The respondents insist that, notwithstanding the states' alleged "anxious hypotheticals", the FCC's "clearly limited preemption" is based on "well settled points of law" which do not threaten the states' exclusive jurisdiction over intrastate ratemaking (GTE, 19-21). In point of fact, the FCC's decision, by its own admission, goes far beyond its previously recognized authority (California Appendix, A.26-48).

Most importantly, if it is upheld by this Court it will sanction the creation of a new jurisdictional framework which is based not on the language of the Act or its Congressional mandate but rather on the FCC's unsanctioned assertion of jurisdiction.

[5] Moreover, under the Fourth Circuit's latest approach, if the FCC determined that permitting the states to set intrastate rates would be "an impediment to the development of interstate facilities" preemption of that function would be permitted, something all parties concede is prohibited by Section 152(b)(1). Nor does it suffice to argue, as respondents do, that such an issue will be dealt with when the need arises. Rather, it is incumbent upon respondents to explain *now* why the setting of depreciation methods is not a "charge, classification, practice, service . . . or regulation" under the terms of Section 152(b)(1). Having failed to do so, the respondents are effectively arguing that Section 152(b)(1) should be ignored.

Respectfully submitted,

JANICE E. KERR*
General Counsel
J. CALVIN SIMPSON
Assistant General Counsel
GRETCHEN DUMAS
Principal Counsel
PEOPLE OF THE STATE OF CALIFORNIA AND THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA
350 McAllister Street
San Francisco, California 94102
* *Counsel of Record*
Telephone: (415) 557-0470

DAVID E. BLABEY
Counsel
LAWRENCE G. MALONE
Assistant Counsel
DEPARTMENT OF PUBLIC SERVICE OF THE STATE OF NEW YORK
Three Empire State Plaza
Albany, New York 12223

FRANK J. KELLEY
Attorney General
LOUIS J. CARUSO
Solicitor General
DON L. KESKEY
LEO H. FRIEDMAN
Assistant Attorney General
THE STATE OF MICHIGAN AND
MICHIGAN PUBLIC SERVICE
COMMISSION
1000 Long Boulevard, Suite 11
Lansing, Michigan 48910
LYNDA S. MOUNTS
CADWALADER, WICKERSHAM & TAFT
1333 New Hampshire Avenue, N.W.
Washington, D.C. 20036
Of Counsel

WILLIAM PAUL RODGERS, JR.
General Counsel
CHARLES D. GRAY
Assistant General Counsel
GENEVIEVE MORELLI
Deputy Assistant
General Counsel
NATIONAL ASSOCIATION OF
REGULATORY UTILITY
COMMISSIONERS
1102 ICC Building
Post Office Box 684
Washington, D.C. 20044

JOEL B. SHIFMAN
Attorney
PUBLIC SERVICE COMMISSION
OF WEST VIRGINIA
201 Brook Street
Post Office Box 812
Charleston, West Virginia 25323

JACK SHREVE, President
NASUCA and Public Counsel
STATE OF FLORIDA
OFFICE OF THE PUBLIC COUNSEL
Room 4, Holland Building
Tallahassee, Florida 32301
BENJAMIN H. DICKENS, JR. ESQ.
CITIZENS OF THE STATE
OF FLORIDA
OFFICE OF PUBLIC COUNSEL
Room 4, Holland Building
Tallahassee, Florida 32301

STEVEN W. HAMM
Consumer Advocate for the
State of South Carolina
RAYMOND E. LARK, JR.
Assistant Consumer Advocate
SOUTH CAROLINA DEPARTMENT
OF CONSUMERS AFFAIRS
2801 Devine Street
Columbia, South Carolina 29250

CHRISTOPHER K. SANDBURG
Special Assistant
Attorney General
MINNESOTA DEPARTMENT OF
PUBLIC SERVICE
1102 Bremer Tower
7th & Minnesota
St. Paul, Minnesota 55101

DAVID LYNCH
Assistant General Counsel
IOWA STATE COMMERCE
COMMISSION
1350 New York Avenue, N.W.,
No. 1023
Washington, D.C. 20008

BRIAN MOLINE
General Counsel
JAMES FLAHERTY
Attorney
KANSAS STATE CORPORATION
COMMISSION
State Office Building
Topeka, Kansas 66612

HOWARD C. DAVENPORT
General Counsel
LLOYD N. MOORE, JR.
MOORE & HICKS
1250 Eye Street, N.W.,
No. 201
Washington, D.C. 20005
Attorneys for Public Service
Commission of the District
of Columbia

STEVEN SCHUR
Chief Counsel
JON KINGSTAD
Assistant Chief Counsel
WISCONSIN PUBLIC SERVICE
COMMISSION
Post Office Box 7854
Madison, Wisconsin 53707

ROBERT WALDRUM
Attorney
ARKANSAS PUBLIC SERVICE
COMMISSION
1000 Center
P.O. Box C-400
Little Rock, Arkansas 72202

KENNETH O. EIKENBERRY
Attorney General
LARRY V. ROGERS
Assistant Attorney General
WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION
Highways-Licenses Building
Olympia, Washington 98504

IRWIN I. KIMMELMAN
Attorney General of
New Jersey
By ALAN S. PRALGEVER
Deputy Attorney General
for the New Jersey Board
of Public Utilities
Division of Law
1100 Raymond Boulevard, No. 316
Newark, New Jersey 07102

JOSEPH I. LIBERMAN
Attorney General
WILLIAM B. GUNDLING
Assistant Attorney General
DEPARTMENT OF PUBLIC UTILITY
CONTROL/STATE OF
CONNECTICUT
1 Central Park Plaza
New Britain, Connecticut 06051

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In The

Supreme Court of the United States

October Term, 1984

CALIFORNIA PUBLIC UTILITIES COMMISSION, et al.,

Petitioners,

v.

FEDERAL COMMUNICATIONS COMMISSION AND UNITED STATES OF AMERICA,

Respondents.

On Petition for A Writ of Certiorari To the United States Court of Appeals for the Fourth Circuit

BRIEF AMICUS CURIAE OF THE STATE OF MAINE AND THE MAINE PUBLIC UTILITIES COMMISSION IN SUPPORT OF THE PETITION FOR A WRIT OF CERTIORARI OF CALIFORNIA PUBLIC UTILITIES COMMISSION, ET AL.

JAMES E. TIERNEY
Attorney General
State House
Augusta, Maine 04333
Attorneys for Amicus Curiae State of Maine

JOSEPH G. DONAHUE
General Counsel
Maine Public Utilities Commission
*WILLIAM E. FURBER, Attorney
242 State Street
Augusta, Maine 04333
(207) 289-3831
Attorney for Maine Public Utilities Commission

* Counsel of Record

COCKLE LAW BRIEF PRINTING CO., (800) 835-7427 Ext. 333

LIST OF PARTIES

People of the State of California and the Public Utilities Commission of the State of California

Virginia State Corporation Commission

Federal Communications Commission and United States of America

North American Telephone Company

Florida Public Service Commission

State of Michigan and Michigan Public Service Commission

Department of Public Utility Control of the State of Connecticut

National Association of Regulatory Utility Commissioners

Southern Pacific Communications Company

Public Service Commission of the District of Columbia

Public Utilities Commission of Ohio

Arkansas Public Service Commission

Kansas State Corporation Commission

GTE Service Corporation

Public Service Commission of Wyoming

Continental Telecom Inc.

Washington Utilities and Transportation Commission

United Telephone Systems, Inc.

Department of Public Service of the State of Minnesota

Arizona Corporation Commission

Cincinnati Bell Inc.

Citizens of the State of Florida, Office of Public Counsel

National Association of State Utility Consumer Advocates

Consumer Advocate of South Carolina

Office of Consumers' Counsel for the State of Ohio

Iowa State Commerce Commission

Public Service Commission of Wisconsin
Public Service Commission of West Virginia
New York State Department of Public Service
The Bell Telephone Company of Pennsylvania
The Chesapeake and Potomac Telephone Company
The Chesapeake and Potomac Telephone Company of Maryland
The Chesapeake and Potomac Telephone Company of Virginia
The Chesapeake and Potomac Telephone Company of West Virginia
The Diamond State Telephone Company
Indiana Bell Telephone Company, Incorporated
Michigan Bell Telephone Company
The Mountain States Telephone and Telegraph Company
New England Telephone and Telegraph Company
New Jersey Bell Telephone Company
New York Telephone Company
Northwestern Bell Telephone Company
The Ohio Bell Telephone Company
Pacific Northwest Bell Telephone Company
The Pacific Telephone and Telegraph Company
Bell Telephone Company of Nevada
South Central Bell Telephone Company
Southern Bell Telephone and Telegraph Company
The Southern New England Telephone Company
Southwestern Bell Telephone Company
Wisconsin Telephone Company
Board of Public Utilities of New Jersey
Louisiana Public Service Commission

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BRIEF AMICUS CURIAE OF THE STATE OF MAINE AND THE MAINE PUBLIC UTILITIES COMMISSION IN SUPPORT OF THE PETITION FOR A WRIT OF CERTIORARI OF CALIFORNIA PUBLIC UTILITIES COMMISSION, ET AL.

INTEREST OF THE STATE OF MAINE AND THE MAINE PUBLIC UTILITIES COMMISSION

The State of Maine regulates intrastate telephone service in Maine by delegating regulatory authority to its Public Utilities Commission. Me.Rev. Stat. Ann. Tit. 35. §§ 1, 4, 15(13), 51 *et seq.* The order of the FCC* which is the subject of this proceeding purports to preempt the states in the determination of proper rates of depreciation

* Amendment of Part 31, Memorandum, Opinion, and Order, 92 FCC 2d 864 (Jan. 6, 1983).

to be used in setting rates for intrastate service, a function within the jurisdiction of the Maine PUC. Neither the State of Maine or the Maine PUC were parties to the proceedings below and therefore may not join the Petition for Certiorari filed by California, 15 other states, and the National Association of Regulatory Utilities Commissioners. However, the Maine PUC became actively interested in the issues raised in the petition when it was made a defendant by New England Telephone and Telegraph Company in an action seeking enforcement of the FCC order which is the subject of this petition. *New England Telephone Company v. Maine Public Utilities Commission,* Order Denying TRO, 565 F.Supp. 949 (D. Maine); Order Granting Permanent Injunction, 570 F.Supp. 1558 (D.Maine); *rev'd* 742 F.2d 1 (1st Cir. 1984); *cert. pending,* Docket 84-900.

SUMMARY OF ARGUMENT

This is the first case in which the FCC has preempted state regulatory authority based on the concern that a federal purpose may be threatened by the *amount* of intrastate revenues for telephone companies approved by state regulatory commissions. This direct concern with the amount of intrastate revenues is prohibited by 47 USC §§ 152(b) and 211(b) and is tantamount to the reinstatement of the *Shreveport* doctrine in the Communications Act despite clear legislative intent to the contrary.

ARGUMENT

The Communications Act Prohibits The FCC From Administratively Preempting State Regulatory Authority Based On A Finding That The Amount Of Intrastate Revenues Authorized By State Regulatory Commissions Threatens A Federal Purpose.

The FCC has broad authority to preempt certain aspects of state regulation of the telephone industry. However, what distinguishes the present case from all others preceding is that the FCC has preempted state authority based on a direct and expressly stated concern over the *amount* of intrastate revenues. This line has never before been crossed. Once crossed, it is difficult to understand how the impact can be contained because there is no apparent basis for distinguishing depreciation as a class of expense from any other component of a telephone company's intrastate revenue requirement.*

* In fact, the economic literature makes clear that depreciation and return on equity are inter-related concepts. Kahn states that "any economic discussion of depreciation should really consider it along with the return on investment." Kahn, *The Economics of Regulation,* New York (1970) Vol. I, page 32. At least two courts have already had to consider the issue of whether the FCC's January 6 preemption order would also prohibit states from adjusting the return on equity to reflect the new depreciation policy. The two courts reached opposite results. Compare *New England Telephone Company v. Public Utilities Commission of Maine,* 579 F. Supp. 1356 (D. Maine 1984) with *South Central Bell Telephone Company v. Louisiana Public Service Commission,* 570 F. Supp. 227 (M.D. La. 1983) Aff'd 744 F.2d 1107 (5th Cir. 1984).

Such a result, as the dissent of Judge Widener points out, completely writes Sections 152(b)* and 221(b)** out of the Communications Act. 737 F.2d at 398. The legislative history of the Communications Act makes clear that these sections were enacted to overrule the holding of *Houston, East and West Railway Company v. United States*, 234 U.S. 342 (1942) (the *Shreveport* rate case) for communi-

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* Section 152(b) reads, in part, as follows:

> [S]ubject to the provisions of Section 301 of this title, nothing in this Act shall be construed to apply or to give the [Federal Communications] Commission jurisdiction with respect to (1) charges, classifications, practices, services, facilities or regulations for or in connection with intrastate communication service by wire . . . of any carrier, or (2) any carrier engaged in interstate or foreign communication solely through physical connection with the facilities of another carrier not directly or indirectly controlling or controlled by, or under direct or indirect common control with such carrier. . . .

** Section 221(b) reads, in part, as follows:

> Subject to the provisions of Section 301, nothing in this Act shall be construed to apply, or to give the [Federal Communications] Commission jurisdiction, with respect to charges, classifications, practices, services, facilities, or regulations for or in connection with wire . . . telephone exchange service . . . even though a portion of such exchange service constitutes interstate or foreign communication, in any case where such matters are subject to regulation by a State commission or by local governmental authority.

cation carriers.* In the *Shreveport* case, this Court held that the ICC could control rates charged for exclusively local service where intrastate rates created an unreasonable burden on interstate commerce.

What the FCC has attempted in this case is tantamount to reinstating the holding of the *Shreveport* rate case in the regulation of the communications industry. The FCC has concluded that the telephone companies do not generate adequate revenues on intrastate operations because of depreciation policies followed by most states, and that this inadequacy in the amount of intrastate revenues may interfere with its policies. This direct concern with the amount of intrastate revenues is expressly stated in the FCC's Order. The FCC described depreciation as a "significant portion of the revenue requirement of regulated telephone companies," and continued:

> Moreover, the extent of state action attempting to prevent carriers from utilizing our depreciation prescriptions places substantial burdens on carriers and could well impair their ability to raise the investment capital they will need to fully compete in the continual evolving competitive telecommunications market.

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* Hearings on S. 2910 before the Senate Committee on Interstate Commerce. 73d Cong. 2d Sess. 153, 155, 178 (1934); Hearing as H.R. 8301 before House Committee on Interstate and Foreign Commerce, 73d Cong. 2d Sess. 70, 134 (1934); 78 Cong. Rec. 8823 (1934); *North Carolina Utilities Commission v. F.C.C.*, 537 F.2d 787, 793 (4th Cir. 1976) (NCUC I); *North Carolina Utilities Commission v. F.C.C.*, 552 F.2d 186 (4th Cir. 1977) (NCUC II). *Computer and Communications Industry Ass'n v. F.C.C.*, 693 F.2d 198, 216 n.99 (D.C. Cir.), *cert. denied*, 103 S.Ct. 2109 (1983). (See Petition for Certiorari, at 14,15.)

Amendment of Part 31, *Memorandum Opinion and Order,* 92 FCC2d 864 (January 6, 1983), Paragraph 37.

None of the cases relied upon by the Fourth Circuit sanction FCC preemption based on a finding that intrastate revenues are inadequate. In *North Carolina Utilities Commission v. F.C.C.,* 537 F.2d 787 (4th Cir. 1976), *cert. denied* 429 U.S. 1027 (1976) (NCUC I) and *North Carolina Utilities Commission v. F.C.C.,* 552 F.2d 186 (4th Cir. 1977) *cert. denied* 434 U.S. 874 (1977) (NCUC II), the Fourth Circuit upheld FCC preemption over the interconnection of customer provided equipment. In *Computer and Communications Industry Ass'n v. F.C.C.,* 693 F.2d 198 (D.C. Cir.). *cert. denied* 103 St. Ct. 2109 (1983) (Computer II), the D.C. Circuit upheld FCC preemption over the tariffing of new terminal equipment based on the F.C.C.'s conclusion that authority over jointly used facilities was essential to effectuate its policies. Both of these cases were based on the conclusion that it was impossible for telephone companies to comply with both federal and state regulatory schemes. Further, in both cases the federal purpose was unrelated to matters of state concern, the need for national uniformity was strong, and the impact on state regulation was considered indirect and unavoidable. In the latter case, the D.C. Circuit expressly recognized the barrier created by 152(b) and 221(b) and the legislative history underlying them and justified the more narrow holding in that case by observing:

> In Computer II the Commission has neither attempted to set rates for intrastate communications service or facilities nor asserted jurisdiction over matters of state concern because of intrastate discrimination against interstate business.

693 F.2d at 216; *Id.* n. 99.

The Fourth Circuit also cites ***Fidelity Federal Savings and Loan Co. v. de la Cuesta,*** 458 U.S. 141 (1982) as support of its high degree of deference to agency determinations in reviewing administrative preemption. However, this Court expressly recognized the limit beyond which administrative preemption may not be sanctioned:

> When the administrator promulgates regulations intended to preempt state law, the court's inquiry is similarly limited: If [h]is choice represents a reasonable accommodation of conflicting policies that were committed to the agency's care by the statute, we should not disturb it ***unless it appears from the statute or its legislative history that the accommodation is not one that Congress would have sanctioned.***

Id. at 154, [Citation omitted, emphasis added.]

That limit is reached in this case. The FCC's January 6 preemption order is in direct conflict with Sections 152(b) and 221(b) and the legislative history underlying them. The Fourth Circuit's decision does not address the legislative history of Sections 152(b) and 221(b) nor does the text give any indication that it was considered. If the FCC can preempt state depreciation policy if it finds that intrastate revenues based on that policy are inadequate and therefore threaten a federal purpose, it is hard to understand why it could not set other elements of the revenue requirement (such as the rate of return) or the rate itself based on a similar finding. However, this is exactly what Sections 221(b) and 152(b) prohibit.

———o———

CONCLUSION

For these reasons, the State of Maine and the Maine Public Utilities Commission urge that this Court issue a Writ of Certiorari to the U.S. Court of Appeals for the Fourth Circuit.

DATED: January 15, 1985

Respectfully submitted,

JAMES E. TIERNEY
Attorney General
State House
Augusta, Maine 04333

Attorneys for Amicus Curiae State of Maine

JOSEPH G. DONAHUE
General Counsel
Maine Public Utilities Commission
*WILLIAM E. FURBER, Attorney
242 State Street
Augusta, Maine 04333
(207) 289-3831

Attorney for Maine Public Utilities Commission

---

* Counsel of Record

(18) (19) (10) (19)

Nos. 84-871, 84-889, 84-1054, and 84-1069

IN THE

Supreme Court of the United States

OCTOBER TERM, 1984

LOUISIANA PUBLIC SERVICE COMMISSION, APPELLANT
vs.
FEDERAL COMMUNICATIONS COMMISSION AND
UNITED STATES OF AMERICA

CALIFORNIA AND PUBLIC UTILITIES COMMISSION
OF CALIFORNIA, ET AL., PETITIONERS
vs.
FEDERAL COMMUNICATIONS COMMISSION AND
UNITED STATES OF AMERICA

PUBLIC UTILITIES COMMISSION OF OHIO,
ET AL., PETITIONERS
vs.
FEDERAL COMMUNICATIONS COMMISSION AND
UNITED STATES OF AMERICA

FLORIDA PUBLIC SERVICE COMMISSION, PETITIONER
vs.
FEDERAL COMMUNICATIONS COMMISSION AND
UNITED STATES OF AMERICA

**On Appeal and On Writs of Certiorari to the
United States Court of Appeals
for the Fourth Circuit**

BRIEF OF PETITIONERS IN No. 84-889

JANICE E. KERR*
General Counsel
J. CALVIN SIMPSON
Assistant General Counsel
GRETCHEN DUMAS
Principal Counsel
People of the State of California and the Public Utilities Commission of the State of California
350 McAllister Street
San Francisco, CA 94102
* *Counsel of Record*
Telephone: (415) 557-0470

DAVID D. BLABEY
General Counsel
LAWRENCE G. MALONE
Counsel
DEPARTMENT OF PUBLIC SERVICE
OF THE STATE OF NEW YORK
Three Empire State Plaza
Albany, New York 12223

(Continued on Inside Front Cover)

BOWNE OF SAN FRANCISCO, INC. • 190 NINTH ST. • S.F., CA 94103 • (415) 864-2300

64 pp

FRANK J. KELLEY
Attorney General
LOUIS J. CARUSO
Solicitor General
DON L. KESKEY
LEO H. FRIEDMAN
Assistant Attorney General
THE STATE OF MICHIGAN AND MICHIGAN PUBLIC SERVICE COMMISSION
1000 Long Boulevard, Suite 11
Lansing, MI 48910

LYNDA S. MOUNTS
STUART J. BASSIN
CADWALADER, WICKERSHAM & TAFT
1333 New Hampshire Ave., N.W.
Washington, D.C. 20036
Of Counsel

WILLIAM PAUL RODGERS, JR.
General Counsel
CHARLES D. GRAY
Assistant General Counsel
GENEVIEVE MORELLI
Deputy Assistant General Counsel
NATIONAL ASSOCIATION OF REGULATORY UTILITY COMMISSIONERS
1102 ICC Building
Post Office Box 684
Washington, D.C. 20044

JOEL B. SHIFMAN
Attorney
PUBLIC SERVICE COMMISSION OF WEST VIRGINIA
STATE CAPITOL
CHARLESTON, WV 25323

JACK SHREVE
OFFICE OF THE PUBLIC COUNSEL
202 Blount Street, Room 624
Tallahassee, FL 32301

JACK SHREVE
NATIONAL ASSOCIATION OF STATE UTILITY CONSUMER ADVOCATES
202 Blount Street, Room 624
Tallahassee, FL 32301

STEVEN W. HAMM
Consumer Advocate for the State of South Carolina
RAYMON E. LARK, JR.
Assistant Consumer Advocate
SOUTH CAROLINA DEPARTMENT OF CONSUMER AFFAIRS
2801 Devine Street
P.O. Box 5757
Columbia, SC 29250

CHRISTOPHER K. SANDBERG
Special Assistant Attorney General
MINNESOTA DEPARTMENT OF PUBLIC SERVICE
1100 Bremer Tower
Seventh & Minnesota
St. Paul, MN 55101

PHILIP STOFFREGEN
General Counsel
PATRICK NUGENT
Deputy Counsel
DAVID LYNCH
Deputy Counsel
IOWA STATE COMMERCE COMMISSION
Lucas State Office Building
Des Moines, IA 50319

BRIAN MOLINE
General Counsel
DONALD LOW
Counsel
KANSAS STATE
CORPORATION
COMMISSION
State Office Building
Topeka, KS 66612

HOWARD C. DAVENPORT
General Counsel
LLOYD N. MOORE, JR.
MOORE & HICKS
1250 Eye Street,
N.W. No. 201
Washington, D.C. 20005
Attorneys for
Public Service
Commission of the
District of Columbia

STEVEN M. SCHUR
Chief Counsel
WISCONSIN PUBLIC SERVICE
COMMISSION
Post Office Box 7854
Madison, WI 53707

ROBERT WALDRUM
Attorney
ARKANSAS PUBLIC SERVICE
COMMISSION
1000 Center
P.O. Box C-400
Little Rock, AR 72202

KENNETH O. EIKENBERRY
Attorney General
LARRY V. ROGERS
Assistant Attorney General
WASHINGTON UTILITIES AND
TRANSPORTATION
COMMISSION
Highways-Licenses Building
Olympia, WA 98504

IRWIN I. KIMMELMAN
Attorney General of
New Jersey
By CARLA VIVIAN BELLO
Deputy Attorney General for
the New Jersey Board of
Public Utilities
Division of Law
1100 Raymond Blvd.,
No. 316
Newark, NJ 07102

JOSEPH I. LIEBERMAN
Attorney General
WILLIAM B. GUNDLING
Assistant Attorney General
PETER J. JENKELUNAS
Assistant Attorney General
PHYLLIS E. LEMELL
Assistant Attorney General
DEPARTMENT OF PUBLIC
UTILITY CONTROL/
STATE OF CONNECTICUT
1 Central Park Plaza
New Britain, CT 06051

QUESTION PRESENTED

Has the Federal Communications Commission exceeded its authority to regulate interstate communications under the Communications Act of 1934, 47 U.S.C. § 151, *et seq.* by preempting state authority to regulate the setting of intrastate depreciation charges and accounting classifications?

LIST OF PARTIES

People of the State of California and the Public Utilities Commission of the State of California

Virginia State Corporation Commission

Federal Communications Commission and United States of America

North American Telephone Company

Florida Public Service Commission

State of Michigan and Michigan Public Service Commission

Department of Public Utility Control of the State of Connecticut

National Association of Regulatory Utility Commissioners

Southern Pacific Communications Company

Public Service Commission of the District of Columbia

Public Utilities Commission of Ohio

Arkansas Public Service Commission

Kansas State Corporation Commission

GTE Service Corporation

Public Service Commission of Wyoming

Continental Telcom Inc.

Washington Utilities and Transportation Commission

United Telephone System, Inc.

Department of Public Service of the State of Minnesota

Arizona Corporation Commission

Cincinnati Bell Inc.

Citizens of the State of Florida, Office of Public Counsel

National Association of State Utility Consumer Advocates

Consumer Advocate of South Carolina

Office of Consumers' Counsel for the State of Ohio

Iowa State Commerce Commission

Public Service Commission of Wisconsin

Public Service Commission West Virginia

New York State Department of Public Service

The Bell Telephone Company of Pennsylvania

The Chesapeake and Potomac Telephone Company

The Chesapeake and Potomac Telephone of Maryland

The Chesapeake and Potomac Telephone Company of Virginia

The Chesapeake and Potomac Telephone Company of West Virginia

The Diamond State Telephone Company

Indiana Bell Telephone Company, Incorporated

Michigan Bell Telephone Company

The Mountain States Telephone and Telegraph Company

New England Telephone and Telegraph Company

New Jersey Bell Telephone Company

New York Telephone Company

Northwestern Bell Telephone Company

The Ohio Bell Telephone Company

Pacific Northwest Bell Telephone Company

The Pacific Telephone and Telegraph Company

Bell Telephone Company of Nevada

South Central Bell Telephone Company

Southern Bell Telephone and Telegraph Company

The Southern New England Telephone Company

Southwestern Bell Telephone Company

Wisconsin Telephone Company

Board of Public Utilities of New Jersey

Louisiana Public Service Commission

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No. 84-889

IN THE

Supreme Court of the United States

OCTOBER TERM, 1984

PEOPLE OF THE STATE OF CALIFORNIA AND PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA, ET AL.,

Petitioners,

VS.

FEDERAL COMMUNICATIONS COMMISSION AND UNITED STATES OF AMERICA,

Respondents.

On Appeal and On Writs of Certiorari to the United States Court of Appeals for the Fourth Circuit

BRIEF OF PETITIONERS

OPINION AND ORDERS BELOW

The opinion of the United States Court of Appeals for the Fourth Circuit, set forth in the Petitioners' Appendix in Case No. 84-889 (Pet. App.) at A-1, is reported at 737 F.2d 388. The Federal Communications Commission's December 22, 1982, Order preempting state prescription of depreciation charges and accounting classifications set forth in the Pet. App. at A-55, is reported at 92 F.C.C.2d 864. The FCC's April 27, 1982, Order finding that the states were not precluded from prescribing different accounting classifications and depreciation charges for intrastate ratemaking set forth in the Pet. App. at A-26, is reported at 89 F.C.C.2d 1094.

JURISDICTION

The Court of Appeals entered judgment on June 18, 1984 (Pet. App. A-1). The Court of Appeals denied rehearing on October 3,

1984 (Pet. App. A-25). The Petition for a Writ of Certiorari in this case was filed on December 10, 1984, and was granted on June 24, 1985. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

STATUTORY PROVISIONS INVOLVED

Relevant statutory provisions are set forth in the Appendix to this brief.

STATEMENT OF THE CASE

I. Background

The Communications Act of 1934 (Communication Act or Act), 47 U.S.C. § 151 *et seq.*, established a dual federal/state system for regulating the provision of wire and radio communications services. Under that system, the Federal Communications Commission (FCC or Commission) regulates interstate communications while the states regulate intrastate communications.

Congress' intent to foster this dual regulatory approach is expressed in Section 2 of the Act, 47 U.S.C § 152.[1] Section 152(b) establishing the scope of state authority, provides in pertinent part:

> [N]othing in this Act shall be construed to apply or give the Commission jurisdiction with respect to (1) charges, classifications, practices, services, facilities, or regulations for or in connection with intrastate communication service by wire or radio of any carrier, or (2) any carrier engaged in interstate or foreign communication solely through physical connection with the facilities of another carrier. . . .

On the basis of the Act's reservation of power to the states, for the last 50 years, state regulatory agencies have been prescribing

[1] Sections 1-5 of the Act were codified at §§ 151-55 of Title 47 of the United States Code. In all other cases, the section numbers of the Act correspond to the section numbers in Title 47. Hereinafter, § 2 would be referrred to as § 152.

intrastate depreciation charges for telephone company plant and accounting classifications for telephone company expenses and taxes as part of their obligation to regulate intrastate communications. As late as April 1982, the FCC, in its Order Denying Preemption,[2] affirmed the well settled division of jurisdiction under the dual regulatory approach imposed by the Act. *See Pacific Tel. and Tel. Co. v. California*, 401 P.2d 353, 372-73 (1965).

The instant appeal is the result of the FCC's reversal of its earlier longstanding application of the Act. In the Preemption Order,[3] the FCC acknowledged its past acceptance of state authority to regulate the depreciation and accounting aspects of local exchange service, but indicated it now was preempting the states of their authority to regulate in this area. Specifically, the FCC preempted all state-authorized depreciation charges and accounting practices and classifications because it believed there was a need for intrastate utilities to accelerate their recovery of capital through depreciation charges to put them in a stronger financial position as they begin to face competition in the intrastate telecommunications industry. Thus, the FCC has extended its regulatory authority into one of the most basic mechanisms by which states have regulated intrastate communications over the last 50 years—the setting of depreciation charges and the establishment of accounting classifications applicable to the setting of rates for intrastate services. Both are fundamental elements of the rate setting process for intrastate service.

[2] *In re Amendment of Part 31, Uniform System of Accounts for Class A and Class B Telephone Companies*, 89 F.C.C.2d 1094 (1982) (Order Denying Preemption) (Pet. App. A-26).

[3] *In re Amendment of Part 31, Uniform System of Accounts for Class A and Class B Telephone Companies*, 92 F.C.C.2d 864 (1983) (Preemption Order) (Pet. App. A-55).

A. Depreciation Charges

Depreciation charges[4] make up a large element of the annual revenue requirement recovered in intrastate rates. *FPC v. Hope Natural Gas Co.*, 320 U.S. 591 (1944); *Lindheimer v. Illinois Bell Telephone Co.*, 292 U.S. 151 (1934); *Smith v. Illinios Bell Telephone Co.*, 282 U.S. 133 (1930). In fact, depreciation charges amount to 10% to 20% of the intrastate revenue requirement. Public utility depreciation accounting is a process by which the cost of an asset[5] is fully recovered in rates over an asset's estimated productive life. National Association of Regulatory Utility Commissioners (NARUC), *Public Utilities Depreciation Practices* (1968). The sole purpose of depreciation is the recovery of investors' original capital investment.[6]

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[4] Depreciation means "the loss in service value not restored by currrent maintenance, incurred in connection with the consumption or prospective retirement of telephone plant in the course of service from causes which are not known to be in current operation, against which the company is not protected by insurance, and the effect of which can be forecast with a reasonable approach to accuracy. Among the causes to be given consideration are wear and tear, decay, action of the elements, inadequacy, obsolescence, changes in the art, changes in demand and requirements of public authorities." Uniform System of Accounts for Class A and Class B Telephone Companies, 47 C.F.R. § 31.01-3.

[5] The term asset as it is used in this context refers not to a single unit but to utility property combined into accounts containing homogeneous units which are then expressed in dollars, not specific units of equipment. National Association of Regulatory Utility Commissioners, *Public Utilities Depreciation Practices* (1968).

[6] Until the instant case, depreciation charges were set by having the individual pieces of equipment grouped together in units by year of installation. Then service lives were set for these units and computed to arrive at over-all service lives for each account. The setting of service lives was done by way of a three-way meeting between the FCC staff, the telephone company and the staff of the state regulatory agency. State and federal authorities have not always agreed on service lives and are not bound by these meetings. *See, N.Y. Tel. Co.*, Opinion 81-3, January 19, 1981; 21 NY/PSC 84, 133-34 (1981). The state or federal jurisdiction then applied its adopted depreciation methodology to the portion of local plant allocated to it by the separations process.

The separations process assigns costs such as telephone property costs, revenues, expenses, taxes and reserves arising from jointly used plant between intrastate and interstate jurisdiction. This separation of costs arising from jointly used plant creates two distinct spheres of regulatory accounting which allows for the separability of the cash recovered through the depreciation process. Both the Act, § 410(c), and this Court, *Smith v. Illinois Bell Telephone Co.*, 282 U.S. 133 (1930), have supported the use of the separations process as a means of allowing state jurisdictions to retain control over intrastate depreciation charges and accounting classifications.

Using the separations process, approximately 75% of the investment in local plant is currently allocated to intrastate services and about 25% to interstate services. Each jurisidiction after applying its own depreciation methodology then comes up with a dollar figure for the depreciation charges. This final figure then becomes part of a company's overall revenue requirement which is recovered in rates for either interstate or intrastate services. Thus, the depreciation procedure provides a means of recovering past capitalized expenditures through rates.

State regulators must exercise their authority over intrastate depreciation charges because decisions relating to the timing of capital recovery of utility assets reflect, to a large extent, local conditions (demand for service, wear and tear, obsolescence, action of the elements) which are not amenable to nationwide estimates. For example, it is state regulators who authorize which telephone company or companies can operate within a given intrastate territory and the types of services such companies can offer. When a state regulatory agency authorizes a telephone company to operate within an area, offer new services or propose rates for services, one of the questions asked is whether premature plant replacement, which must be reflected in depreciation charges, will occur because of increased customer demand for basic telephone service, enhanced services (call forwarding, conference calling), new information age services (information access service, data transmission) or service upgrades (multi-party service). The FCC has never been in a position to forecast these demand factors on a region-by-region basis.

Further, in order to replace plant equipment, a company must be able to obtain financing at reasonable costs. Since the FCC does not regulate intrastate utility financing, it is not in a position to forecast the optimal time for discretionary upgrades and replacements. Many state commissions do have this regulatory responsibility.

Finally, under the FCC depreciation methods, a utility which is not actually facing premature plant replacement because of lack of customer demand for "new information age" services or lack of competitive pressures will be able to collect higher than warranted depreciation charges through the raising of local rates. This utility will in effect be given a windfall of cash which may be beyond what the utility realistically needs.

B. Accounting

A utility's expenses and taxes, comprising about 80% of its revenue requirements, are calculated on the basis of the analysis of costs for particular services. The services are broken down by accounting categories. These accounting categories are the regulatory accounting practices and classifications used by a utility company as directed by the particular state regulatory agency. Many state regulatory agencies have adopted the FCC's Uniform System of Accounts for Class A and Class B Telephone Companies, 47 CFR § 31.01-3, or similar systems to avoid requiring extensive duplicate records.[7] However, to effectuate a state's own ratemaking policy, states can require carriers to maintain separate intrastate accounting records for a few accounts, or for many accounts. Kripke, *A Case Study in the Relationship of Law and Accounting: Uniform Accounts 100.5 and 107*, 57 Harv. L. Rev. 433, 438 (1944); Order Denying Preemption, 89 F.C.C.2d at 1107 (Pet. App. A-46). If the FCC's Preemption Order is allowed to stand, states will not be able to require utility companies to maintain accounting records different from those required by the FCC. Such a result will make it extremely difficult, as a

[7] All utilities keep separate accounting records, in any event, for depreciation expenses used to compute income taxes (i.e. accelerated depreciation).

practical matter, for states to perform ratemaking computations different from those of the FCC.[8]

The FCC's preemption of depreciation charges and accounting classifications is a direct challenge to the historically accepted interpretation of the Act whereby states, not the FCC, have jurisdiction over intrastate depreciation charges and accounting classifications.

II. Proceedings Below

On March 31, 1981, the FCC issued an Order (Expensing Order) establishing expensing and amortization rules to replace depreciation procedures that had previously applied to the expenses incurred in connecting a telephone line to the telephone system.[9]

On April 20, 1981, the People of the State of California and the Public Utilities Commission of the State of California filed a Petition for Reconsideration, and the National Association of Regulatory Utility Commissioners filed a Petition for Clarification, both directed at the Expensing Order. The Petitions requested the FCC to clarify whether the Expensing Order preempted states from prescribing depreciation rates and using accounting practices and classifications for intrastate communications which differed from those used by the FCC.

In April, 1982, the FCC found that its Expensing Order did *not* preclude the states from utilizing different accounting and depre-

[8] This result could also, as a practical matter, interfere with the implementation of state and federal holdings that the uniform system of accounts is not determinative for ratemaking at the state and federal level. *Alabama-Tenn. Nat. Gas Co. v. FPC*, 359 F.2d 318 (5th Cir. 1966); *Washington Pub. Interest Org. v. Pub. Serv. Comm. of the District of Columbia*, 393 A.2d 71, 81-82 (D.C. 1978); *Kansas Power & Light Co. v. State Corp. Comm. of Kansas*, 620 P.2d 329, 339 (Kan. Ct. App. 1980).

[9] *In re Amendment of Part 31, Uniform System of Accounts for Class A and Class B Telephone Companies*, 85 F.C.C.2d 818 (1981) (Expensing Order).

ciation procedures for intrastate ratemaking. Order Denying Preemption, 89 F.C.C.2d at 1108 (Pet. App. A-47). The FCC reasoned, based on a substantive review of the legislative history of the Communications Act, that Section 220[10] of the Act did not "preclude state commissions from departing from accounting or depreciation rules prescribed by this Commission for purposes of regulating intrastate telecommunications service rates." 89 F.C.C.2d at 1097 (Pet. App. A-31). The FCC also concluded that no valid federal policy would be frustrated if states employed their own accounting practices and classifications and depreciation charges. *Id.* According to the FCC, "[n]o policy of this Commission would be furthered by requiring state commissions to adhere to the depreciation and accounting rules we have adopted for purposes of computing the interstate revenue requirement. If carriers adhere to our rules for purposes of computing the interstate revenue requirement, our purpose will be achieved." *Id.* at 1107 (Pet. App. A-46). The FCC as well as American Telephone & Telegraph Company (AT&T) conceded that for years states have kept separate records, and that "federal regulation will not be frustrated if carriers maintain additional records for other purposes." *Id.* at 1108 (Pet. App. A-47).

AT&T and GTE Service Corporation sought reconsideration of the Order Denying Preemption before the FCC.[11] Upon reconsideration, the FCC reversed its earlier stand and adopted its Preemption Order of December 22, 1982, 92 F.C.C.2d 864 (Pet. App. A-80). This is the Order before this Court.

In its Preemption Order, the FCC determined that states were preempted from prescribing depreciation charges and accounting classifications which are inconsistent with those of the FCC. It did so for two reasons which it had rejected in its earlier Order

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[10] Section 220 of the Act gives the FCC authority to set depreciation charges and accounting classifications for *interstate* companies. 47 U.S.C. § 220.

[11] They also sought judicial review in the United States Court of Appeals for the District of Columbia Circuit. *Amer. Tel. & Tel. v. FCC*, appeal docketed, No. 82-1747 (D.C. Cir. 1980) and *GTE Serv.Corp. v. FCC*, appeal docketed No. 82-1752 (D.C. Cir. 1982).

Denying Preemption: (1) It concluded that the language and history of Section 220 of the Communications Act preempted the states in this area, and (2) it determined that state regulation of depreciation and accounting practices would frustrate or interfere with the achievement of federal regulatory goals. On this latter point, the FCC alleged there was frustration of the general Congressional goal, as expressed in Section 151 of the Act which created the FCC for the purpose of regulating interstate communication, which was to make available, " 'so far as possible, to all the people of the United States a rapid, efficient, Nation-wide, world-wide wire and radio communication service with adequate facilities at reasonable charges . . . ' ". 92 F.C.C. 2d at 876 (citing 47 U.S.C. § 151), (Pet. App. A-73-74). More specifically, the FCC asserted that "[s]tate depreciation rate prescriptions that do not adequately provide for capital recovery in the competitive environment" would frustrate the FCC's goal of encouraging competition "in those markets found capable of supporting competition." *Id.*

The Virginia State Corporation Commission filed a petition for review of the Preemption Order in the Court of Appeals for the Fourth Circuit, with numerous other state agencies and organizations intervening.[12]

On June 18, 1984, the Fourth Circuit upheld the FCC's Preemption Order on the ground that preemption was necessary to prevent frustration of the federal purpose contained solely in Section 15 of the Act, 47 U.S.C. § 151, *Virginia State Corp. Comm'n. v. FCC*, 737 F.2d 388 (4th Cir. 1984) (Pet. App. A-1). Despite the specific reservation of authority to the states in Sections 152(b) and 221(b) to prescribe charges, practices and classifications for intrastate telephone service, the Court determined that "the foregoing provisions are rendered against a statutory backdrop that places *primary emphasis* upon a 'rapid, efficient, Nation-wide, and world-wide communication service,' " 737 F.2d at 392, (Pet. App. A-10) (Emphasis added), and concluded that preemption was justified because "interstate communications would undoubtedly be affected by the states' imposi-

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[12] See list of parties, *supra*.

tion of depreciation policies . . . ". *Id.* at 395 (Pet. App. A-16).[13] The court found it unnecessary as a matter of law to reach the question whether Section 220 of the Act required preëmption by the FCC.

In contrast, the dissent concluded that preemption of state prescribed depreciation charges and accounting classifications was neither permissible nor appropriate. Section 220(b) "cannot be read to 'require preemption' of state-imposed depreciation practices for the intrastate portion of carriers' operations." *Id.* at 397 (Pet. App. A-20) (Widner, J. dissenting).

The dissent asserted that the FCC had manufactured a conflict to justify its preemption of state jurisdiction. *Id.* at 398 (Pet. App. A-21). "[F]or all practical purposes", the conflict here is "nonexistent, and has been created by the FCC to rationalize a base for its decision." *Id.*

The dissent observed that the FCC must want to give the monopolistic local telephone companies more revenue now so that they can be aggressive in future non-regulated aspects of local service and any other business areas in which they can compete.[14]

[13] The court did acknowledge that the policy conflict surrounding depreciation rates was "more attenuated than the very direct effect produced by physical connection of equipment to interchangeable lines . . . ." 737 F.2d at 395, (Pet. App. A-16). This was the situation found in the earlier physical impossibility preemption cases. Specifically, the Court was referring to *North Carolina Utilities Comm'n v. FCC*, 537 F.2d 787 (4th Cir. 1976), *cert. denied*, 429 U.S. 1027 (1976); *North Carolina Utilities Comm'n v. FCC*, 552 F.2d 1036 (4th Cir. 1977), *cert. denied*, 434 U.S. 876 (1977); *and Computer and Communications Industry Ass'n v. FCC*, 693 F.2d 198 (D.C. Cir. 1984), *cert. denied*, 461 U.S. 938 (1983). In each of these cases the court observed that when separability of intrastate and interstate facilities is possible, as it is in the instant case, much of the potential for conflict is eliminated. *Smith v. Illinois Bell Telephone Co.*, 282 U.S. 133 (1930).

[14] "The upshot of the case is that the FCC decided that the carriers needed more revenue than the state regulatory agencies were willing to provide, so it decided to impose different depreciation rates on intrastate equipment for the very purpose of, and thus effectively, raising the

Yet, the FCC could find no provision in the Act authorizing preemption of local charges and classifications to increase industry earnings. *Id.* at 398. (Pet.App. A-22).

If the FCC's Order is permitted to stand, the effect would be to rewrite the Act to eliminate the states' legitimate regulatory role. As the dissent concluded:

> If the FCC can achieve preemption of state-prescribed depreciation methods by reciting the shibboleth of encouraging competition with as little showing of federal-state conflict as it has made here, it has effectively written 47 U.S.C. §§ 152(b) and 221(b) out of the Communications Act. It seems to me that any ratemaking changes that the carriers want can be adopted, if they persuade the FCC that they need the money, for any FCC adoption may be imposed on the States by virtue of the Supremacy Clause on the ground that the resultant additional revenue will help carriers in some theoretical way to compete in some market that need not even be specified, as it was not here. ***The logical result of this decision is to permit the FCC to abrogate completely the state regulation of intrastate ratemaking for the carriers' intrastate operations in violation of the Communications Act.*** (Emphasis added.)

Id. at 398 (Pet. App. A-22).

SUMMARY OF ARGUMENT

The issue in this case is whether the Communications Act of 1934 authorizes the FCC to preempt the states' traditional function of setting depreciation charges and accounting classifications for local telephone service. This Court consistently has held that preemption is justified only where Congress intended to

intrastate rates of the subscribers just as surely as if it had done so directly. I can find neither justification nor authority in the Communications Act for this action." 737 F. 2d at 399, (Pet.App. A-22-23).

(Also see Judge Greene's decision strongly criticizing the Bell Operating Companies' entrance into new businesses because it might interfere with their monopoly local exchange service (*United States v. Amer. Tel. & Tel.*, C.A. No. 82-0192, entered on July 26, 1984).

preempt state regulation or there is an actual conflict between state and federal regulation. There is no basis for preemption in this case.

1. Section 152(b)(1) expressly reserves to the states the authority to set depreciation charges and accounting classifications for intrastate ratemaking. The legislative history of Section 152(b)(1) confirms that Congress intended to preserve state authority to regulate intrastate communication.

2. Even if the explicit language of Section 152(b)(1) is ignored, nothing in the Communications Act authorizes the FCC to preempt state regulation. The FCC's reliance on Section 220, which authorizes the FCC to set depreciation charges and accounting classifications for plant assigned to interstate communication, is misplaced. Section 220(j), as enacted, envisions regulation by federal and state regulators within their own spheres of authority, with the prospect of future Congressional action to harmonize the systems, if necessary. The legislative history of this subsection, as well as the rest of Section 220, confirms that Congress did not intend to authorize the FCC to preempt intrastate depreciation charges or accounting classifications. Read together, Sections 152(b)(1) and 220(j) reflect Congress' determination to safeguard the states' control of local regulation, to tolerate the diversity of dual regulation and to defer the issue of preemption of state regulation of depreciation and accounting for future legislation, if necessary.

3. Moreover, state regulation of depreciation charges and accounting classifications for intrastate ratemaking does not actually conflict with federal law. The general purpose clause of the Communications Act, Section 151, is too broad and too vague to justify preemption, when other parts of the Act explicitly give jurisdiction to the states. Further, there is no actual conflict between state and federal regulation, as defined by this Court's decisions. As Congress intentionally designed a system of dual federal-state regulation, dual regulation does not frustrate federal policies.

ARGUMENT

I. SECTION 152(b)(1) AND ITS LEGISLATIVE HISTORY DEMONSTRATE CONGRESSIONAL INTENT TO RESERVE TO THE STATES THE DEVELOPMENT OF INTRASTATE DEPRECIATION CHARGES AND ACCOUNTING CLASSIFICATIONS

This Court consistently has articulated a stringent legal standard for determining whether federal law preempts state law. Where federal action preempts activities traditionally regulated by the states, such as telephone service, the Court " 'start[s] with the assumption that the historic police powers of the States were not to be superseded . . . unless that was the clear and manifest purpose of Congress.' " *Hillsborough County v. Automated Medical Laboratories, Inc.*, 105 S. Ct. 2371, 2376 (1985) (quoting *Jones v. Rath Packing Co.*, 430 U.S. 519, 525 (1977)); *Arkansas Electric Cooperative Corp. v. Arkansas Public Service Commission*, 461 U.S. 375, 377 (1983).

Accordingly, the Court has sharply delimited the situations in which it will find that federal law invalidates state law. The preemption doctrine, which has its roots in the Supremacy Clause, U.S. Const. art. VI, cl. 2, "requires [the Court] to examine Congressional intent."[15] *Fidelity Federal Savings and Loan Ass'n v. de la Cuesta*, 458 U.S. 141, 152 (1982). The court has found Congressional intent to preempt state law (1) where there is an explicit statement of legislative intent to preempt, (2) where the legislative intent may be inferred from the pervasiveness of the federal regulation, or (3) where the intent may be

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[15] In addition, state regulation may be preempted by federal law "to the extent that it actually conflicts with federal law." *de la Cuesta*, 458 U.S. at 153. Actual conflict will occur where compliance with both state and federal regulations is a physical impossibility, *Florida Lime and Avocado Growers, Inc. v. Paul*, 373 U.S. 132 (1963), or where state regulations stand as an "obstacle to the accomplishment and execution of the full purposes and objectives of Congress." *Hillsborough*, 105 S. Ct. at 2375, *quoting Hines v. Davidowitz*, 312 U.S. 52, 67 (1941).

inferred because the federal interest in the field is so dominant.[16] *Hillsborough*, 105 S. Ct. at 2375.

Federal regulations, as well as federal statutes, may have preemptive effect. When a federal agency seeks to preempt state law, the Court must examine "whether the [agency] meant to preempt [the state] law, and, if so, whether the action is within the scope of the [agency's] delegated authority." *de la Cuesta*, 458 U.S. at 154.

In this case, the FCC has expressed its intent to preempt state regulation of depreciation and accounting for intrastate ratemaking. 92 F.C.C.2d at 880 (Pet. App. A-79). However, the inquiry does not end there. An agency's authority is "rooted in a grant of such power by the Congress and subject to limitations which that body imposes." *Chrysler Corp. v. Brown*, 441 U.S. 281, 302 (1979). Thus, the question of agency authority turns on Congressional intent. *de la Cuesta*, 458 U.S. at 162.

Applying these standards to this case, the FCC has failed to justify preemption. The Communications Act reserves the authority to set intrastate depreciation charges and accounting classifications to the states. The Act does not authorize the FCC to preempt such authority. Rather, it carefully limits the agency's authority to interstate communications. 47 U.S.C. § 152(a).

A. Section 152(b)(1) Reserves the States' Jurisdiction Over Intrastate Depreciation Charges and Accounting Classifications

Section 152(b)(1) denies the FCC jurisdiction over "charges, classifications, [and] practices" relating to intrastate telephone

[16] Here, Congressional intent to preempt the entire field of telecommunications may not be inferred from the pervasiveness of the federal regulation of the field because the Act clearly leaves at least some aspects of intrastate communications for state regulation. *See, e.g.*, § 152(b). Similarly, the federal interest in intrastate communications is not sufficient to justify an inference of preemptive intent based upon the dominant federal interest in the field. *See Hillsborough*, 105. S. Ct. at 2378; *Hines v. Davidowitz*, 312 U.S. 52 (1941) (recognizing dominant federal interest only in the sphere of foreign relations).

communications. These terms of art include *depreciation* and *accounting*.

This Court repeatedly has held that where Congress has used technical terms of art to define jurisdictional boundaries, they should be interpreted by reference to the industry or trade to which they apply. *Corning Glass Works v. Brennan*, 417 U.S. 188 (1974). As shown below, academicians, regulators, industry experts, and the courts all traditionally have referred to depreciation and accounting in terms of " charges", "practices", and "classifications". *Smith v. Illinois Bell Telephone Co.* 282 U.S. 133, 158 (1930), Kahn, *The Economics of Regulation* 117-122 (1970); Priest, *Principles of Utility Regulation* 112-16 (1969); NARUC, *Public Utility Depreciation Charges* 2 (1968).[17]

Since their inception, the Interstate Commerce Commission (ICC) and the FCC have repeatedly described depreciation as "charges, classifications and practices".[18] In fact the FCC Order under review defines depreciation as "*charges*, to operating expense" which recover capitalized costs over time. 92 F.C.C.2d at 851 (Pet. App. A-61). It can hardly be contested, therefore, that Section 152(b)(1)'s prohibition against the FCC's development of intrastate "charges, classifications, and practices" forecloses preemption of depreciation and accounting.

Textbooks, professional treatises, utilities, regulators and the courts consistently have defined accounting in terms of "classifi-

[17] The framers of the Communications Act consistently discussed depreciation and accounting in terms of "charges" and "classifications". S. Rep. No. 781, 73d Cong., 2d Sess. (1934); H.R. Rep. 8301, 73d Cong., 2d Sess. 17 (1934). Indeed, § 220 empowers the FCC to set interstate 'depreciation charges'.

[18] As noted below, the ICC regulated interstate communication prior to the creation of the FCC. *E.g., Depreciation Charges of Telephone Companies*, 118 I.C.C. 295 (1926); *In re Amendment of Part 31 Uniform System of Accounts for Class A and Class B Telephone Companies*, FCC Docket No. 82-679 (1982); *In re Prescription of Revised Percentages of Depreciation*, FCC Docket No. 82-93 (1983); *Amendment of Annual Report Form M*, FCC Docket No. 82-513 (1982).

cations", "practices", and "regulations."[19] Indeed, the FCC repeatedly has described accounting in these terms and did so in both its Order Denying Premption and the Preemption Order under review. It is clear, therefore, that Congress was preserving the states' exclusive jurisdiction over intrastate depreciation charges and accounting classifications, and practices in connection with intrastate communication service.

B. The Legislative History of Section 152(b)(1) Evidences Congress' Intent to Reserve Local Depreciation and Accounting Matters to the States

The legislative history of Section 152(b)(1) demonstrates Congress' intent to preserve state power to regulate intrastate communication. As the Committees considering the Act reported, Section 152 "reserves to the States exclusive jurisdiction over intrastate telephone and telegraph communication." S. Rep. No. 781, 73d Cong., 2d Sess. 3 (1934). *See also* H.R. Rep. No. 1850, 73d Cong., 2d Sess. 4 (1934). Congress specifically invited the state regulators to draft the provision[20] which ultimately became Section 152(b)(1)[21] for the purpose of preserving state

[19] *E.g., Norfolk v. Western Ry Co.*, 287 U.S. 134 (1932); Phillips, *The Economics of Regulation* (1969).

[20] During the Senate hearings on S.6, Senator Dill invited state commission representatives to submit language reserving this authority to the state commissions. *Hearings on S. 6 Before the Senate Interstate Commerce Committee*, 71st Cong., 2d Sess. 2180 (1930). *See also, Hearings on H.R. 8301 Before the House Interstate and Foreign Commerce Committee*, 73d Cong., 2d Sess. 16 (1934) (statement of Dr. Stewart). For the state proposals, *see* S. __, 73d Cong., 2d Sess. § 210 (Feb. 10, 1934) (Confidential Comm. Print No. 2); H.R. 8301, 73d Cong., 2d Sess. § 210 (Feb. 27, 1934) (Committee Print).

[21] The state proposal originally appeared as § 210 of the Act. During the Act's development, however, Congress moved this provision to § 152(b). A statement by one of the ICC commissioners indicates that the move was made because it was "more logical" to place all of the provisions relating to the Act's application in a single section. *Hearings on S. 2910 Before Senate Interstate Commerce Committee*, 73d Cong., 2d Sess. 210 (1934) (statement of Mr. McManamy).

regulatory authority. Thus, Congress' enactment of Section 152(b)(1) represents a significant substantive effort to preserve state authority over intrastate communications.

Moreover, Congress was well aware that tensions would develop where state regulation of intrastate communication affected the federal regulation of interstate communications. The legislative history of the Communications Act shows that Congress elected not to extend the FCC's authority over interstate communication to include such intrastate regulation which affected interstate communications.

Congress' experience with railroad regulation under the Interstate Commerce Act had demonstrated the effect of such an extension of federal authority. In *Houston, East and West Texas Railroad Co. v. United States*, 234 U.S. 342 (1914) (the *Shreveport Rate Cases*),[22] the Supreme Court recognized the ICC's authority to set intrastate rates where those rates had an effect on interstate rates. Relying on this authority, the ICC had almost completely supplanted state railroad regulation.

The Communications Act's legislative history indicates that Congress sought to prevent a similar division of regulatory authority over telecommunications. Congress recognized that the *Shreveport* doctrine allowed the FCC to supplant state authority over intrastate communication. Expressing a desire to leave the bulk of communications regulation with the states,[23] Congress

[22] *See also Railroad Comm'n of Wisconsin v. Chicago Burlington & Quincy Railroad Co.*, 249 U.S. 563 (1922). The rule was ultimately codified in the 1920 Amendments to the Transportation Act.

[23] *See Hearings on S. 6 Before the Senate Interstate Commerce Committee*, 73d Cong., 2d Sess. 2133, 2152 (1930) (statements of Sen. Dill); *id.* at 2179 (statement of Sen. Smith); *id.* at 2141 (statement of Sen. Brookhart) (intent to "safeguard the rights of the States . . . "); *id.* at 2184-85 (statement of Sen. Smith) (under *Shreveport* doctrine, regulation of the limited interstate business can dominate intrastate regulation).

made clear its intent to protect state authority over telecommunications from application of the *Shreveport* doctrine.[24]

A fair reading of Section 152(b)(1) and its legislative history leaves little doubt that Congress intended to preserve, for the indefinite future, the states' authority to regulate intrastate telecommunications, including regulations which affect interstate regulation. As Congress has expressly evidenced its willingness to tolerate accounting and depreciation practices which may be at odds with FCC policies, state regulation cannot frustrate the FCC's lawful purposes. Specifically, this Court has stated that:

> In an area in which Congress has decided to tolerate a substantial measure of diversity, the fact that the implementation [of a state policy may impair the implementation of a federal policy] is not a sufficient reason for concluding that Congress intended to preempt that exercise of state power.

New York Telephone Co. v. New York Dept. of Labor, 440 U.S. 519, 546 (1979).

The FCC thus has no authority to override Congress' preservation of the states' exclusive jurisdiction over local depreciation and accounting matters.

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[24] Senator Dill, the Chairman of the Interstate Commerce Committee and sponsor of both S. 2910 and S. 3285, stated:

> [W]e wrote in certain provisions that are not in the Interstate Commerce Act, to protect the State commissions against being overridden by this Commission, as the Interstate Commerce Commission has overridden some of the railroad State commissions.

Hearings on S.2910 Before the Senate Interstate Commerce Committee, 73d Cong., 2d Sess. 179 (1934). *See also* 78 Cong. Rec. 8823 (1934) (statement of Sen. Dill); *Hearings on H.R. 8301 Before the House Interstate and Foreign Commerce Committee*, 73d Cong., 2d Sess. 74 (1934) (statement of Mr. Clardy).

II. NEITHER SECTION 220 NOR ANY OTHER PROVISION OF THE COMMUNICATIONS ACT CONTAINS THE "DIRECT AND UNAMBIGUOUS" LANGUAGE REQUIRED TO AUTHORIZE THE FCC's PREEMPTION ORDERS

Even if one ignores the explicit language of Section 152 (b) (1), the Communications Act cannot be read to authorize preemption. Preemption requires a showing (particularly where state regulation pre-dates Congressional action) of clear Congressional authorization to override state regulation. *Silkwood v. Kerr-McGee Corp.*, 104 S. Ct. at 625. The Communications Act, however, offers no evidence of a Congressional intent to preempt. Indeed, even Section 220, the linchpin for the Commission's preemption theory, demonstrates Congress' decision to preserve the states' traditional power in this area.

A. The Communications Act's Historical Context Explains Congress' Reasons for Preserving the State's Power Over Local Depreciation and Accounting

The historical context in which the Act developed is critical to determining the Act's preemptive intent. If Congress, aware of state regulatory activity, had intended to preempt state regulation, it would have expressed that intent in "direct and unambiguous language." Absent such language, Congressional intent to preempt should not be inferred. *New York State Dept. of Social Service v. Dublino*, 413 U.S. 405, 414 (1973).

Prior to the development of the Act, federal regulation of telecommunications was limited, with state regulators assuming most of the regulatory burden. *Hearings on S. 2910 Before the Senate Committee on Interstate Commerce*, 73d Cong., 2d Sess. 81 (1934) (statement of Walter S. Gifford, Pres., Amer. Tel. & Tel.) (states presently regulate telephone rates). The Interstate Commerce Commission regulated interstate telephone service, 36 Stat. 545 (1910), but it[25] recognized the states' primary role in

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[25] At that time, the ICC had scant resources and little reason to regulate telecommunications, much less infringe on state regulation. This was so for two reasons. First, public attention was focused not on

regulating intrastate telephone service.[26] Indeed, in 1926, the ICC declared that:

> The great bulk of telephone business is of strictly local concern, and the state commissions are much better informed and equipped than we are to pass upon the conditions surrounding the local service.

Depreciation Charges of Telephone Companies, 118 I.C.C. 295, 374 (1926).

The ICC therefore rejected industry requests that it preempt the states' development of intrastate depreciation charges and accounting classifications. *Id.* Similarly, the Supreme Court acknowledged the role of state regulators in establishing depreciation charges in connection with intrastate telephone service and the appropriateness of using separate federal and state charges of depreciation for the same property. *Smith v. Illinois Bell Telephone Co.*, 282 U.S. 133, 148 (1930).

It is understandable, therefore, that the Act does not contain even the hint of language authorizing FCC preemption of intrastate regulation. Rather, the Act as a whole indicates an intent not to preempt the states, but to safeguard state regulation of local charges and classifications.[27] As Congress did not make the requisite "direct and unambiguous" expression of an intent to authorize preemption, the FCC's effort to preempt state depreciation regulation is invalid and must be set aside.

telephone communications but on the need for railroad reform, which had been the ICC's primary responsibility since its creation in 1887. *See*, 78 Cong. Rec. 4134 (1934) (statement of Sen. Dill). Second, since over 90% of all telephone calls were intrastate (originated and completed within a single state's borders), state legislatures had already become relatively well-equipped to regulate telephone facilities. As early as 1912, various Bell System Companies and state regulatory agencies had already developed a methodology for "separating" telephone plant expenses and revenues devoted jointly to interstate/intrastate calling. *See*, FCC/NARUC Separations Manual, 2.

[26] *See, e.g.*, Transportation Act of 1920, § 407, 41 Stat. 27 (1920).

[27] Congress in the Act did not intend to "greatly change or add to existing law." H.R. Rep. No. 1850, 73d Cong., 2d Sess. 3 (1934).

B. The Enactment of Section 220 Without Any Reference to Intrastate Depreciation Charges or Accounting Classifications Further Demonstrates Congress' Intent to Preserve the States' Exclusive Jurisdiction Over Intrastate Regulation

In its Order Denying Preemption, the FCC concluded that "*at most* this legislative history indicates that . . . the 1934 Congress was *not sure* whether reenactment of the Interstate Commerce Act language would or would not preempt state accounting and depreciation rules and did not choose to resolve the question at that time." 89 F.C.C. 2d at 1106 (Pet. App. A-44). (Emphasis added.) However, in its subsequent Preemption Order, the FCC claimed that "the more persuasive reading of the legislative history supports the construction that Section 220(b) preempts inconsistent state action where the Commission has prescribed depreciation rates for a carrier." 92 F.C.C. 2d at 873 (Pet. App. A-69).

It is Section 220(j) which addresses the relationship of state and federal regulation. As finally enacted, that section expressly assumed dual regulation of depreciation and accounting matters. Moreover, a review of Section 220's legislative history, and that of its predecessor—Section 20(5) of the Interstate Commerce Act—belies the FCC's conclusion. Section 20(5) was not intended to preempt the states' development of either intrastate depreciation charges or accounting classifications, and its reenactment in the Communications Act, without reference to intrastate depreciation and accounting, evidenced Congress' satisfaction with the status quo; that is, the states' development of intrastate depreciation and accounting.

1. Section 220(j), As Finally Enacted, Assumed Dual Regulation of Depreciation Charges and Accounting Classifications

Section 220(j) governs the relationship of state and federal authority in establishing depreciation rates. Section 220(j) provides:

The Commission shall investigate and report to Congress as to the need for legislation to define further or harmonize the powers of the state commissions with respect to matters to which this section relates.

47 U.S.C. § 220(j). Thus, the statute envisions regulation by federal and state regulators each within their own spheres of authority. It specifically leaves the issue of preemption and the relationship between the actions of these regulators for future legislation.

Nothing in the legislative history of the Communications Act indicates a contrary Congressional intent. The original bill attempted to safeguard the states' jurisdiction of intrastate matters through a predecessor to Section 152(b)(1), *see* note 21, *supra*, and a proposed Section 220(j), which provided:

(1) Nothing in this section shall limit the power of a State commission to prescribe, for the purposes of the exercise of its jurisdiction with respect to any carrier, the percentage rate of depreciation to be charged to any class of property of such carrier, or the composite depreciation, for the purpose of determining charges, accounts, records, or practices; or (2) relieve any carrier from keeping any accounts, records, or memoranda which may be required to be kept by a State commission in pursuance of authority granted under State law.

H.R. 8301, 73d Cong., 2d Sess. § 220(j) (1934) (as introduced); S.2910, 73d Cong., 2d Sess. § 220(j) (1934) (as introduced).

Under this provision, FCC depreciation and accounting regulation pursuant to Sections 220(a) and (b) would not preempt state accounting and depreciation regulation.

The Senate Committee on Interstate Commerce modified Section 220(j) to remove its protection of the states' authority to set intrastate depreciation charges and accounting classifications.[28] The revised bill, which was passed as S. 3285 and referred to the House Committee on Interstate and Foreign Commerce,

[28] That bill provided:

(Footnote continued on following page)

implicitly assumed that the FCC was able to preempt the states' development of depreciation charges and accounting classifications.[29]

The House Committee on Interstate and Foreign Commerce thereafter modified S.3285 to reinstate the original Section 220(j), which expressly prohibited preemption. The House adopted this provision, creating a conflict with the Senate's bill.

The provision ultimately negotiated in the House-Senate conference and subsequently enacted into law removed any suggestion of preemption and deferred further consideration of the issue until the FCC had an opportunity to 1) study the current system; and 2) report back to Congress. Specifically,

The substitute adopts . . . a modified provision *for investigation and report to Congress* as to the need for defining or harmonizing Federal and State authority in respect to other

(j) The Commission shall investigate and report to the Congress whether in its opinion legislation is desirable (1) authorizing the Commission to except the carriers of any particular class or classes in any State from any of the requirements under this section in cases where such carriers are subject to State commission regulation with respect to matters to which this section relates; and (2) permitting the State commissions, in pursuance of authority granted under State law, to prescribe their own percentage rates of depreciation or systems of accounts, records, or memoranda to be kept by carriers.

S.3285, 73d Cong., 2d Sess. § 220(j) (1934) (as passed by Senate).

[29] "Section 220(j) of the Senate bill (relating to accounts and depreciation charges) authorizes the Commission to investigate and report to Congress upon the desirability of legislation . . . permitting State commissions to prescribe *their own* percentage rates of depreciation and systems of accounts for carriers." (Emphasis added.) H.R. Rep. No. 1918, 73d Cong., 2d Sess. 47 (1934). Obviously, no purpose was to be served in investigating the propriety of permitting the states to develop their own depreciation charges and accounting classifications unless the FCC had first preempted them, an event which had not taken place as of 1934. Thus, S. 3285's Section 220(j) assumes FCC preemption.

matters [i.e., those relating to accounts and depreciation charges]. (Emphasis added.)

H.R. Rep. No. 1918, 73d Cong., 2d Sess. 47 (1934). Thus, the new Section 220(j) assumed dual regulation of depreciation and accounting, with the prospect of future Congressional action to "harmonize" the system, if necessary.

2. Sections 220(h) and (i) reflect Congress' Recognition of the States' Predominant Role in the Development of Depreciation Charges

Similarly, Section 220(h) (which authorizes the FCC to waive compliance with its depreciation and accounting orders) and Section 220(i) (which requires the FCC to notify state commissions of its proposed actions regarding "accounts, records or memoranda") do not assume that the FCC could preempt the states' development of depreciation charges and accounting classifications for intrastate operations. Rather, the waiver and notice procedures found in these provisions simply reflect the fact that the FCC, in its early years, lacked the experience, expertise, and funding to set *interstate* depreciation charges. 1938 F.C.C. ANN. REP. 32; 1940 F.C.C. ANN. REP. 34. Thus, in Section 220(h), Congress gave the FCC discretion to permit the states to set *interstate* depreciation rates "where such carriers [were] subject to state commission regulation."[30] Likewise, Section 220(i) required the Commission to draw on the states' expertise in setting *interstate* depreciation charges and accounting classifications.

The FCC's current reading of Sections 220(h) and (i) is also contradicted by the fact that these provisions were introduced in the same bill which included the original Section 220(j), discussed above. The original Section 220(j) undeniably prohibited preemption. Congress could not have assumed that Sections 220(h) and (i) authorized FCC preemption of state regulation when Section 220(j) expressly prohibited preemption.

[30] Pursuant to § 152(b)(2) the states have traditionally set *all* depreciation charges for non-affiliated, independent telephone companies.

3. Section 20(5) of the Interstate Commerce Act Did Not Authorize the Interstate Commerce Commission to Preempt Either Intrastate Depreciation Charges or Accounting Classifications

The FCC concluded that Section 220(b) authorized preemption because its predecessor, Section 20(5) of the Interstate Commerce Act, allegedly "preempted the State commissions' jurisdiction over depreciation." 92 F.C.C. 2d at 873 (Pet. App. A-69).[31] The legislative history of Section 20(5) offers no support for the Commission's position.

Section 20(5) was enacted as part of the 1920 Transportation Act almost fifteen years before the creation of the Federal Communications Commission. While several sections of the Interstate Commerce Act expressly preempted state regulation, *e.g.*, Section 20(a)(7) (state securities regulation) and Section 13(4) (state discriminatory ratemaking), Section 20(5) did not do so. Thus, when the ICC was asked to preempt the states from setting depreciation methods for intrastate telephone plant, it refused because "the state commissions are much better informed and equipped than we are to pass upon the conditions surrounding the local service . . . ". *Depreciation Charges of Telephone Companies,* 118 I.C.C. 295, 374 (1926).

As the FCC originally acknowledged, Section 20(5), offers no basis from which to imply a Congressional intent to authorize depreciation preemption in Section 220:

> Inasmuch as Section 20 had never been construed to restrict state commissions from requiring carriers to keep additional records for purposes of intrastate ratemaking and Court decisions in analogous contexts did not adopt an expansive interpretation of that provision, the reenactment of that language should not be interpreted to restrict State commis-

[31] Section 220(a), relating to accounting, stemmed from the Hepburn Act of 1906. As the Commission originally recognized, "there is no indication in the legislative history of the Hepburn Act that the 1906 Congress wished to curb State regulation . . . ". Order Denying Preemption, 89 F.C.C. 2d at 1099 (Pet. App. A-33).

> sions from keeping such additional records in the absence of clear evidence that the 1934 Congress intended to produce that result.

Order Denying Preemption, 89 F.C.C. 2d at 1102 (Pet. App. A-36). Section 20(5) made no reference to preemption, intrastate depreciation, or a need for uniformity, and therefore it was never held to authorize preemption.

By modeling Section 220(b) upon Section 20(5) Congress evidenced its satisfaction with the status quo; that is, the states' development of intrastate depreciation charges and accounting classifications. Therefore, the FCC may not claim that Section 220 expressly authorizes preemption.

III. THERE IS NO CONFLICT BETWEEN FEDERAL AND STATE REGULATION OF DEPRECIATION CHARGES OR ACCOUNTING CLASSIFICATIONS THAT REQUIRES PREEMPTION

In recognition of the strong presumption against preemption, the Court has sharply delineated those situations in which it finds that the Supremacy Clause, U.S. Const. art. VI, cl. 2, invalidates state law. Preemption will be justified under the Supremacy Clause only where (1) compliance with both state and federal regulation is physically impossible;[32] or (2) state regulation represents "an obstacle to the accomplishment and execution of the full purposes and objectives of Congress." *Hillborough County*,

[32] The Fourth Circuit conceded that "physical impossibility" does not apply to this case. Telephone companies may comply with federal and state regulations by maintaining separate books of accounts and by setting depreciation charges only on the joint plant allocated to them by the separations process. *Virginia State Corp. Comm'n v. FCC*, 737 F.2d 388, 396 (4th Cir. 1984) (Pet. App. A-16). *See also North Carolina Utilities Comm'n v. FCC*, 552 F.2d 1036 (4th Cir. 1977), *cert. denied*, 434 U.S. 874 (1977); *North Carolina Utilities Comm'n v. FCC*, 537 F.2d 787 (4th Cir. 1976), *cert. denied*, 429 U.S. 1029 (1976); *Computer and Communications Ass'n v. FCC*, 693 F.2d 198 (D.C. Cir. 1982), *cert. denied*, 461 U.S. 938 (1983).

105 S. Ct. at 2375 (quoting *Hines v. Davidowitz*, 312 U.S. 52, 67 (1941)).

As discussed below, the FCC's general purpose of regulating interstate communication to make "available, so far as possible . . . a rapid, efficient, Nation-wide . . . communications service", 47 U.S.C. § 151, is too broad and vague to support conflict preemption. Specifically, general purpose language such as that found in Section 151 embodied solely in the preamble of the Act cannot be used to infer a Congressional objective to preempt when other parts of the Act explicitly give jurisdiction to the States. Moreover, state law "must do 'major damage' to 'clear and substantial' federal interests before the Supremacy Clause will demand that state law be overridden". *Hisquierdo v. Hisquierdo*, 439 U.S. 572, 581 (1979). As demonstrated, the alleged frustration of federal policies caused by dual regulation does not meet this standard.

A. The Communications Act's General Purpose Clause, Section 151, Does Not Support Preemption of State Regulation of Intrastate Communication

1. Section 151 Does Not Establish a Sufficiently Definite Federal Purpose to Support Preemption When Other Parts of the Act Explicitly Give Jurisdiction Over Intrastate Communication to the States

The lone statutory source for the federal interest in the development of a national communications service is the Act's general purpose clause, Section 151. This provision serves two functions. It lists four "purposes" of the Act and creates the FCC "to execute and enforce the provisions of this Act.[33] Notably, Section 151 identifies the statutory purpose of the FCC as

[33] Section 151 provides:

> For the purpose of regulating interstate and foreign commerce in communication by wire and radio so as to make available, so far as possible, to all the people of the United States a rapid, efficient, Nation-wide and world-wide wire and radio communication service with adequate facilities at reasonable charges, for the purpose of the

regulating *interstate* . . . commerce in communication by wire . . . so as to make available, so far as possible, . . . a rapid, efficient, Nation-wide, and world-wide wire and radio communication service . . .

47 U.S.C. § 151. (Emphasis added.)

A plain reading of the statutory language demonstrates that Congress did not intend to give the FCC broad powers to regulate intrastate communications. While Section 151 clearly enunciates a goal of developing a national telecommunications service, this section urges accomplishment of this goal only through regulation of "interstate communication." Thus, the language of Section 151 does not support a broad exercise of regulatory power over intrastate communications by the FCC.[34]

national defense, for the purpose of promoting safety of life and property through the use of wire and radio communication, and for the purpose of securing a more effective execution of this policy by centralizing authority heretofore granted by law to several agencies and by granting additional authority with respect to interstate and foreign commerce in wire and radio communication, there is hereby created a commission to be known as the "Federal Communications Commission", which shall be constituted as hereinafter provided, and which shall execute and enforce the provisions of this Act.

47 U.S.C. § 151.

[34] The legislative history of § 151 further supports such a limited reading of the statute. When Congress considered the Act, there was very little discussion of § 151. Both the Senate and House reports simply stated that § 151 declared the purpose of the Act and established the FCC. S. Rep. No. 781, 73d Cong., 2d Sess. 3 (1934); H.R. Rep. No. 1850, 73d Cong., 2d Sess. 4 (1934). Neither the Conference Report's analysis of the bill, H.R. Rep. No. 1918, 73rd Cong., 2d Sess. 45 (1934), nor the floor debate explain this section. 78 Cong. Rec. 8823 (1934) (Sen. Dill's introducing bill begins with discussion of Sec. 2; *id.* at 10313). (Rep. Rayburn's introducing bill simply notes that the section states the Act's purpose and creates the FCC). Given the widespread interest in the relationship between state and federal regulation, § 151 would have received much more attention if Congress had viewed the provision as altering the division of regulatory authority between the FCC and the states.

In similar cases, this Court has ruled that when Congress explicitly gives states jurisdiction over an area, broad statements of general federal policies do not justify preemption of state regulations when that policy is not developed further by any specific operative provisions of the statute.[35] For example, in *Pacific Gas & Electric Co. v. State Energy Resources Conservation & Development Comm'n,* 461 U.S. 198 (1983), the party seeking preemption argued that state law frustrated the Atomic Energy Act's purpose to develop the commercial use of nuclear power. The Court found that, even though Congress' purpose was to develop nuclear power, the promotion of this purpose could not be accomplished "at all costs" when Congress had explicitly preserved state authority. General statements in federal statutes, although reflecting Congress' desire to encourage a certain activity, do not demonstrate a Congressional intent to preempt all state actions that may have an adverse impact especially when the Congressional intent to preempt is not unmistakably clear. *Pacific Gas & Electric Co.,* 461 U.S. 198; *Silkwood v. Kerr McGee Corp.,* 104 S.Ct. 615 (1984); and *Arkansas Electric Cooperative Corp. v. Arkansas Public Service Comm'n,* 461 U.S. 375 (1983). When this test is not met, "the *legal reality* remains that Congress has left sufficient authority in the states . . . ". 461 U.S. at 223 (Emphasis added). Thus, as Section 151 is indefinite, the FCC may not use it as a basis for preemption.

[35] Interpreting the § 151 reference to the Communications Act's purpose of establishing an interstate telecommunications network, the District of Columbia Circuit has stated:

> This longterm goal which the Commission sets out for itself apparently has its roots in the general purpose section of the Act, 47 U.S.C. § 151. While that section does set forth worthy aims towards which the Commission should strive, it has not heretofore been read as a general grant of power to take any act necessary and proper to those ends. Especially in view of our conclusion that § 152(b) seems to bar Commission jurisdiction in this case, *see* Section I *supra,* we are extremely dubious about the legal substance of this argument by the Commission, even if the facts were available to support it.

National Ass'n of Regulatory Utility Commissioners v. FCC, 533 F.2d 601, 613-14 n. 77 (D.C. Cir. 1976).

2. Section 151 Does Not Establish a Sufficiently Narrrow Federal Purpose to Support Preemption

This Court has consistently refused to use broadly stated purpose language, such as that found in Section 151, as a basis for preemption. *E.g., Commonwealth Edison Company v. Montana*, 453 U.S. 609, 633-34 (1981). In that case, the Court rejected the contention that a state mining tax was preempted by "national energy policies . . . encouraging the production and use of coal . . . ". *Id.* at 633. Such broad statements would not be interpreted as a Congressional decision to preempt conflicting state law. *Id.* 633-34. Instead, the Court ruled that it must "look beyond general expressions of 'national policy' to specific federal statutes with which the state law is claimed to conflict" to justify preemption. *Id.* at 634.[36]

Preemption based upon a conflict with the federal interest in "rapid development of interstate facilities" is equally inappropriate. As the Fourth Circuit dissent recognized, allowing preemption based upon a recitation of "the shibboleth of encouraging competition . . . " would "permit the FCC to abrogate completely the state regulation of intrastate ratemaking." *Virginia State Corporation Comm'n v. FCC*, 737 F.2d at 398 (Widener, J. dissenting) (Pet. App. A-22).[37] Moreover, such a result conflicts

[36] An earlier decision interpreting the Act demonstrates these same principles. *Head v. New Mexico Board of Examiners in Optometry*, 374 U.S. 424 (1963). In *Head*, the Court rejected a contention that state professional advertising regulation was preempted by a Congressional authorization that the FCC review broadcast license applications under a "public interest, convenience and necessity" standard which arguably included advertising content. A broad scheme of state advertising regulation would not be preempted "when the grant of power to the Commission was accompanied by no substantive standard other than the 'public interest . . . '." 374 U.S. at 431.

[37] Specifically, the dissent found that the conflict relating to competition was "for all practical purposes nonexistent, and has been created by the FCC to rationalize a base for its decision". *Virginia State Corp. Comm'n v. FCC, supra*, 737 F.2d at 398 (Pet. App. A-21). The dissent supported this finding by pointing out the vague position the FCC had taken regarding the connection between depreciation and competition.

(Footnote continued on following page)

with the dual federal-state regulatory scheme underlying the Act. Accordingly, under the rationale of *Commonwealth Edison Co. v. Montana*, 453 U.S. at 634, and *Exxon Corp v. Governor of Maryland*, 437 U.S. 117 (1978), a conflict with the FCC's broad competitive policies for the interstate market does not justify preemption of state regulation of the intrastate market.

B. The Extent of the Conflict Between State and Federal Regulation, If Any, Is Not Sufficient to Justify Preemption Due to Frustration of Federal Purposes

Assuming, *arguendo*, that this Court reaches the conflict preemption question, the FCC has not met its burden of establishing a conflict between state and FCC policy which can be shown substantially to frustrate the objectives and purposes of Congress. This Court has required substantially more than inconsistency between the state and federal regulations before it has preempted state regulation as frustrating federal purposes. Preemption is justified only where state regulation "substantially frustrates national . . . policies." *Commonwealth Edison Co. v. Montana*, 453 U.S. at 633. State law "must do 'major damage' to 'clear and substantial' federal interests before the Supremacy Clause will

For example, the FCC claimed its newly prescribed depreciation methods, which give the carriers more revenue in earlier years, better reflect economic reality and thus will increase market efficiency, encourage technological innovation, and otherwise promote competition. The dissent noted that the FCC never defined the relevant marketplace. It is unclear whether the FCC was referring to the interstate market for long distance service, the intrastate market for long distance service, the equipment market, the local service market or some other market. The FCC also never offered any support for the proposition that there is a connection between capital recovery through depreciation charges and the creation of competition in some marketplace. The dissent found that the FCC's

> ". . . unsupported and unsupportable statements as to the effect on competition of inconsistent state depreciation methods, do not provide even a modicum of reasoned analysis supporting the FCC's decision to interfere in state ratemaking after several decades of affirmatively espousing the opposite conclusion."

737 F.2d at 399 (Pet. App. A-23).

demand that state law be overridden." *Hisquierdo v. Hisquierdo*, 439 U.S. at 581. Especially where Congress envisioned dual regulation, preemption doctrine recognizes that some tension between federal and state regulation should be tolerated. *Silkwood v. Kerr-McGee Corp.*, 104 S. Ct 615 (1984); *Pacific Gas and Electric Co. v. State Energy Resources Conservation and Development Comm'n*, 461 U.S. 198 (1983).

The Court's recent decision in *Hayfield Northern Railroad Co. v. Chicago and Northwestern Transportation Co.*, 104 S. Ct. 2610 (1984), indicates that substantial conflict between the federal and state regulatory scheme will be tolerated before state law will be preempted. *Hayfield* involved the Staggers Act Amendments to the Interstate Commerce Act establishing a procedure for allowing railroads to abandon unprofitable routes. After the federal agency authorized abandonment by the railroad, Minnesota sought to use its condemnation authority to prevent the railroad from dismantling the railroad bed for use elsewhere. The Court recognized a conflict between the federal purpose of promoting competition, efficiency and productivity in the railroad industry and the state condemnation procedure. Viewing the statutory scheme as a whole, however, the Court ruled that "state condemnation authority is not preempted merely because it may frustrate the economically optimal use of rail assets." *Id.* at 2619. Accordingly, the state action was allowed to stand.

Conversely, the cases in which the Supreme Court has preempted state regulation because of frustration of federal objectives have involved actual conflicts. In *Lawrence County v. Lead-Deadwood School District*, 105 S. Ct. 695 (1985), the Court preempted a state statute which required local governments to distribute funds received from the federal government in lieu of taxes on federal land in the manner they distributed regular tax revenue. The federal statute authorized local governments to spend this money for "any governmental purpose". The federal system, therefore, gave local officials greater flexibility in determining how they would spend the federal funds. The Court found that the effect of compliance with the state statute was to deprive local governments of the flexibility which the federal stature sought to provide and to drain the federal statute of almost all

meaning. 105 S. Ct. at 699. The state statute was preempted, therefore, because it frustrated the federal purpose of providing flexibility to local officials.

The state action in this case involves regulation of intrastate communications. It does not affect the ability of the FCC to establish depreciation policies applicable to interstate communications. This is not a case like *Lawrence County* where compliance with state regulations will drain the federal action "of all meaning". Accelerated depreciation, as prescribed by the FCC, will remain the rule for interstate communications. Thus, state regulation does not "frustrate" federal goals.

Even if there were a significant conflict between state regulation and the federal purpose, this conflict would not require preemption. In *Pacific Gas and Electric Co. v. State Energy Resources Conservation and Development Comm'n*, 461 U.S. 198 (1983), the Court acknowledged that the Atomic Energy Act gave the federal government exclusive control over the safety aspects of nuclear energy, *id.* at 205, and that "a primary purpose of the Atomic Energy Act was . . . the promotion of nuclear power". *Id.* at 221. Nevertheless, the court allowed state economic regulation to stand. In the Court's view, Congress intentionally designed a system of dual federal-state regulation of nuclear power. *Id.* at 211-12. Because of this division of regulatory power, the court ruled that state regulation would not be preempted as frustrating the federal purpose if it slowed or even stopped the development of nuclear power. *Id.* at 223. Redefinition of the regulatory scheme to prevent states from exercising their proper authority in a manner which "undercut federal objectives," was a matter for legislative, not judicial action. *Id.* at 223.

Similarly, the Communications Act creates a scheme of dual federal-state regulation. As the Court found in *Pacific Gas and Electric Co.*, some tension between these competing schemes must be tolerated so long as each sovereign is acting within its proper sphere of authority. Where reconcilable conflicts arise, preemption of state regulation is inappropriate. So long as state telecommunication regulation stays within the proper sphere of state authority, the Court should not preempt state regulation

even if it "undercuts" federal regulatory goals in some ill-defined way. If the FCC desires to change this result, it should seek legislation from Congress altering the regulatory scheme, not seek a judicial redefinition of the regulatory scheme through the use of preemption.

Congress, well aware of the stresses and strains on the Communications Act's regulatory scheme in this "information age," has not changed the Act. Instead Congress has preserved the dual regulation of telecommunications. Indeed, "if the Commission believes it needs additional remedial power . . . it should seek such power from Congress . . . . [The courts are] no more authorized than is the Commission to rewrite the law". *Interstate Commerce Comm'n v. American Trucking Ass'n, Inc.*, 104 S. Ct. 2458 (1984) (O'Connor, Blackmun, Powell, Stevens, J.J. dissenting). In failing to await Congressional action, the FCC has acted as though "Congress needs . . . help from generous judicial implication to achieve the supercession of state authority"—despite the ability of "Congress [to] speak with drastic clarity whenever it chooses to assure full federal authority, completely displacing the states". *Bethlehem Steel Co. v. New York Labor Relations Board*, 330 U.S. 767, 780 (1947) (separate opinion of Frankfurter, Murphy and Rutledge, JJ.).

C. The States' Regulation of Intrastate Depreciation Charges And Accounting Classifications Does Not Frustrate The FCC's Lawful Purposes

The FCC in its Order Denying Preemption found that if "the carriers maintain the records we require for purposes of interstate ratemaking, federal regulation will not be frustrated if carriers maintain additional records for other purposes". 89 FCC 2d at 1108 (Pet. App. A-47). However, in its Preemption Order, the FCC reversed its earlier reading (not only of the law, but of the facts) and suggested, for the first time in its 47 year history, that dual regulation of depreciation charges and accounting classifications frustrated the implementation of FCC general purposes found in Section 151. 92 F.C.C. 2d at 876 (Pet. App. A-74). The FCC explained its new position by claiming that preemption was needed to:

(1) assure the utilities' timely recovery of capital investments through local rates; which would allegedly,

(2) encourage technological innovation; which would allegedly,

(3) protect the utilities' ability to compete with new entrants to their markets, thereby safeguarding a "rapid and efficient" telecommunications system.

Id. at 876-78 (Pet. App. A-74-75). Each of these positions, however, provides no basis for establishing the type of conflict which this Court has found necessary to justify preemption.

1. Preemption Is Not Needed to Assure the Utilities' Timely Recovery of Capital in Local Rates Because State Regulators Are Already Required to Set Intrastate Depreciation Charges Which Allow for Timely Capital Recovery

The Fourteenth Amendment prohibits state governments from taking the private property of their citizens without rendering them "just compensation." In 1894, the Supreme Court extended the protection of the Fourteenth Amendment to investor-owned utilities when it held, "justice demands that everyone should receive some compensation for the use of his money or property". *Reagan v. Farmers' Loan and Trust Company*, 154 U.S. 362, 412 (1894).

Since the late nineteenth century, state regulators have assumed the responsibility of setting intrastate depreciation charges which preserve the financial integrity of telephone corporations and other public utilities within their jurisdictions. In fact, they have operated under statutory constraints (calling for "just and reasonable" rates) which, in some instances, go beyond constitutional safeguards. *E.g., Matter of New York Telephone Co. v. Public Service Comm'n*, 309 N.Y. 569, 576-578 (1956). Aside from the legal requirements for timely capital recovery, state regulators are well aware that, if they do not allow for timely capital recovery, a utility's long term financial position may be compromised. State ratepayers are the ones who will ultimately pay for this regulatory misjudgment.

Thus, the FCC's claim that preemption is needed to assure utilities' timely recovery of capital investments is a fiction. Not only does it assume that state regulators will ignore their statutory and constitutional responsibilites (which they have not done), but that state courts will suddenly offer no redress to aggrieved utilities. Neither supposition has the slightest basis in fact. Hence, no conflict exists.

2. Preemption Will Not Spur Plant Replacement Because the Level of Depreciation Charges Has, at Best, Only an Indirect Effect on System Planning

Depreciation is a mechanism used to recover investment in existing plant. Capital recovery through depreciation charges does not serve as a sinking fund for plant replacement.

In analyzing the need for new plant (or plant replacement) system planners address a wide variety of factors, including: (1) a company's overall financial health; (2) its ability to raise capital as well as its level of internally generated funds or retained earnings; (3) its estimated financing costs; (4) the cost of operating the new facility versus the cost of operating the facility to be replaced; and (5) the operational advantages of the new facility over the old.

While increased cash flow caused by higher depreciation charges could indirectly encourage plant replacement, this is only one of many factors for consideration by a utility. Moreover, state regulators unquestionably would retain the discretion to reduce utilities authorized returns on equity in recognition of their increased cash flow.[40]

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[40] The FCC's *sua sponte* attempt to increase internally generated utility funds should be contrasted with the action taken by Congress in the late 1960's to protect the government's tax base while encouraging utility plant expansion with interest free capital. Section 167(1) of the Internal Revenue Code allows telephone companies to take accelerated depreciation for tax purposes but conditions their ability to do so on regulatory agencies *not* flowing through the deferred tax benefits to the customer 26 U.S.C. § 167 (L). *Abrams v. Pub. Serv. Comm'n*, 91

In any event, the FCC cannot reasonably suggest that the states' past depreciation policies have in any way discouraged technological innovation or plant replacement. The telecommunications industry has witnessed remarkable change during its 47 years of dual regulation. The effects of these technological leaps have been reflected in the depreciation charges set by the states. The FCC's position that preemption is needed suddenly to encourage adequate plant replacement has no basis in fact. Hence, there is no frustration of federal purpose.

3. Increased Depreciation Charges Will Not Improve The Intrastate Telephone Companies' Competitive Strength

The FCC reasons that accelerated capital recovery will improve the intrastate telephone companies' ability to compete with new entrants to their markets. Its assumption is counter-intuitive because higher prices normally decrease a product's marketability.[41] The only way preemption could increase the intrastate companies' market strength would be by offering them an opportunity to accelerate their recovery of monopoly investments now, while competition is still weak, so they may reduce their future prices and drive out new entrants to their markets. This result is contrary to the FCC's policy to further competition. Dual regulation has not, and will not, frustrate the FCC's implementation of its legitimate purposes under Section 151.

Thus, theoretical and minor differences between jurisdictions, such as those alleged by the FCC in this case, do not justify preemption. *Hayfield Northern Railroad Co. v. Chicago and Northwestern Transportation Co.*, 104 S.Ct. at 2610. The decision under review should therefore be reversed.

A.D.2d 795 (3d Dept), *appeal dismissed*, 59 N.Y.2d 760 (1983). There is no such mechanism in the FCC preemption order, nor could there be.

[41] In any event, even if the FCC were correct in its supposition, the question would arise how strengthening the market control of an already dominant carrier furthers competition.

CONCLUSION

There is no basis for justifying federal preemption of state regulation of depreciation charges and accounting classifications for intrastate ratemaking. Section 152(b)(1) of the Communications Act expressly reserves the development of all intrastate depreciation charges and accounting classifications to the states. No other provision of the Act authorizes the FCC to preempt. Section 220 simply authorizes the Commission to set depreciation charges and accounting classifications for the plant assigned to interstate communication. The section does not alter the jurisdictional division of authority established by Section 152. It cannot be read to override the specific madate of Section 152(b)(1).

The express reservation of authority to the states in Section 152(b)(1) renders the FCC's "frustration" argument academic. It is, nonetheless, clear that dual regulation has not, and will not, frustrate or conflict with the FCC's implementation of its lawful purposes. The FCC simply cannot be permitted to stretch the general purpose of language of Section 151 into a Congressional invitation to override the states' traditional authority over intrastate depreciation charges and accounting classifications.

WHEREFORE, Petitioners respectfully request this Court to reverse the Order of the Court of Appeals.

Respectfully Submitted,

JANICE E. KERR*
General Counsel
J. CALVIN SIMPSON
Assistant General Counsel
GRETCHEN DUMAS
Principal Counsel
People of the State of California and the Public Utilities Commission of the State of California
350 McAllister Street
San Francisco, CA 94102
* *Counsel of Record*
Telephone: (415) 557-0407
DAVID D. BLABEY
General Counsel
LAWRENCE G. MALONE
Counsel
DEPARTMENT OF PUBLIC SERVICE OF THE STATE OF NEW YORK
Three Empire State Plaza
Albany, New York 12223

FRANK J. KELLEY
Attorney General
LOUIS J. CARUSO
Solicitor General
DON L. KESKEY
LEO H. FRIEDMAN
Assistant Attorney General
THE STATE OF MICHIGAN AND MICHIGAN PUBLIC SERVICE COMMISSION
1000 Long Boulevard, Suite 11
Lansing, MI 48910

LYNDA S. MOUNTS
STUART J. BASSIN
CADWALADER, WICKERSHAM & TAFT
1333 New Hampshire Ave., N.W.
Washington, D.C. 20036
Of Counsel

WILLIAM PAUL RODGERS, JR.
General Counsel
CHARLES D. GRAY
Assistant General Counsel
GENEVIEVE MORELLI
Deputy Assistant General Counsel
NATIONAL ASSOCIATION OF REGULATORY UTILITY COMMISSIONERS
1102 ICC Building
Post Office Box 684
Washington, D.C. 20044

JOEL B. SHIFMAN
Attorney
PUBLIC SERVICE COMMISSION OF WEST VIRGINIA
STATE CAPITOL
CHARLESTON, WV 25323

JACK SHREVE
OFFICE OF THE PUBLIC COUNSEL
202 Blount Street, Room 624
Tallahassee, FL 32301

JACK SHREVE
NATIONAL ASSOCIATION OF STATE UTILITY CONSUMER ADVOCATES
202 Blount Street, Room 624
Tallahassee, FL 32301

STEVEN W. HAMM
Consumer Advocate for the State of South Carolina
RAYMON E. LARK, JR.
Assistant Consumer Advocate
SOUTH CAROLINA DEPARTMENT OF CONSUMER AFFAIRS
2801 Devine Street
P.O. Box 5757
Columbia, SC 29250

CHRISTOPHER K. SANDBERG
Special Assistant Attorney General
MINNESOTA DEPARTMENT OF PUBLIC SERVICE
1100 Bremer Tower
Seventh & Minnesota
St. Paul, MN 55101

PHILIP STOFFREGEN
General Counsel
PATRICK NUGENT
Deputy Counsel
DAVID LYNCH
Deputy Counsel
IOWA STATE COMMERCE COMMISSION
Lucas State Office Building
Des Moines, IA 50319

BRIAN MOLINE
General Counsel
DONALD LOW
Counsel
KANSAS STATE CORPORATION COMMISSION
State Office Building
Topeka, KS 66612

HOWARD C. DAVENPORT
General Counsel
LLOYD N. MOORE, JR.
MOORE & HICKS
1250 Eye Street, N.W. No. 201
Washington, D.C. 20005
Attorneys for Public Service Commission of the District of Columbia

STEVEN M. SCHUR
Chief Counsel
WISCONSIN PUBLIC SERVICE COMMISSION
Post Office Box 7854
Madison, WI 53707

ROBERT WALDRUM
Attorney
ARKANSAS PUBLIC SERVICE COMMISSION
1000 Center
P.O. Box C-400
Little Rock, AR 72202

KENNETH O. EIKENBERRY
Attorney General
LARRY V. ROGERS
Assistant Attorney General
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION
Highways-Licenses Building
Olympia, WA 98504

IRWIN I. KIMMELMAN
Attorney General of New Jersey
By CARLA VIVIAN BELLO
Deputy Attorney General for the New Jersey Board of Public Utilities
Division of Law
1100 Raymond Blvd., No. 316
Newark, NJ 07102

JOSEPH I. LIEBERMAN
Attorney General
WILLIAM B. GUNDLING
Assistant Attorney General
PETER J. JENKELUNAS
Assistant Attorney General
PHYLLIS E. LEMELL
Assistant Attorney General
DEPARTMENT OF PUBLIC UTILITY CONTROL/ STATE OF CONNECTICUT
1 Central Park Plaza
New Britain, CT 06051

Appendix

Communications Act of 1934, as amended

47 U.S.C. § 151

SEC. 1. For the purpose of regulating interstate and foreign commerce in communication by wire and radio so as to make available, so far as possible, to all the people of the United States a rapid, efficient, Nation-wide, and world-wide wire and radio communication service with adequate facilities at reasonable charges, for the purpose of the national defense, for the purpose of promoting safety of life and property through the use of wire and radio communication[1] and for the purpose of securing a more effective execution of this policy by centralizing authority heretofore granted by law to several agencies and by granting additional authority with respect to interstate and foreign commerce in wire and radio communication, there is hereby created a commission to be known as the "Federal Communications Commission," which shall be constituted as hereinafter provided, and which shall execute and enforce the provisions of this Act.

47 U.S.C. § 152

SEC. 2. (a) The provisions of this Act shall apply to all interstate and foreign communication by wire or radio and all interstate and foreign transmission of energy by radio, which originates and/or is received within the United States, and to all persons engaged within the United States in such communication or such transmission of energy by radio, and to the licensing and regulating of all radio stations as hereinafter provided; but it shall not apply to persons engaged in wire or radio communication or transmission in the Canal Zone, or to wire or radio communication or transmission wholly within the Canal Zone.[2]

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[1] The provisions relating to the promotion of safety of life and property was added by "An Act to amend the Communications Act of 1934, etc." Public No. 97, 75th Congress, approved and effective May 20, 1937, 50 Stat. 189.

[2] The words "the Philippine Islands or" preceding "the Canal Zone" are omitted on authority of Proc. No. 2695, effective July 4, 1946, 11

(b)[3] Except as provided in section 224 and subject to the provisions of section 301, nothing in this Act shall be construed to apply or to give the Commission jurisdiction with respect to (1) charges, classifications, practices, services, facilities, or regulations for or in connection with intrastate communication service by wire or radio of any carrier, or (2) any carrier engaged in interstate or foreign communication solely through physical connection with the facilities of another carrier not directly or indirectly controlling or controlled by, or under direct or indirect common control with such carrier, or (3) any carrier engaged in interstate or foreign communication solely through connection by radio, or by wire and radio, with facilities, located in an adjoining State or in Canada or Mexico (where they adjoin the State in which the carrier is doing business), of another carrier not directly or indirectly controlling or controlled by, or under direct or indirect control with such carrier, or (4) any carrier or which clause (2) or clause (3) would be applicable except for furnishing interstate mobile radio communication service or radio communication service to mobile stations on land vehicles in Canada or Mexico; except that sections 201 through 205 of this Act, both

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Fed. Reg. 7517, 60 Stat. 1352, recognizing the independence of the Philippine Islands.

[3] Subsection 2(b) was amended by adding the words, "Except as provided in section 224 and" at the beginning of the subsection by section 5, Public Law 95-234, approved February 21, 1978, 92 Stat. 33. The subsection was previously amended to read as above by Public Law 345, 83d Congress, 2d Session, approved April 27, 1954, 68 Stat. 63. This subsection formerly read as follows:

(b) Subject to the provisions of section 301, nothing in this Act shall be construed to apply or to give the Commission jurisdiction with respect to (1) charges, classifications, practices, services, facilities, or regulations for or in connection with intrastate communication service of any carrier, or (2) any carrier engaged in interstate or foreign communications solely through physical connection with the facilities of another carrier not directly or indirectly controlling or controlled by, or under direct or indirect common control with such carrier; except that sections 201 to 205 of this Act, both inclusive, shall, except as otherwise provided therein, apply to carriers described in clause (2).

inclusive, shall, except as otherwise provided therein, apply to carriers described in clauses (2), (3), and (4).

47 U.S.C. § 221

(b) Subject to the provisions of section 301 of this title, nothing in this chapter shall be construed to apply, or to give the Commission jurisdiction, with respect to charges, classifications, practices, services, facilities, or regulations for or in connection with wire, mobile, or point-to-point radio telephone exchange service, or any combination thereof, even though a portion of such exchange service constitutes interstate or foreign communication, in any case where such matters are subject to regulation by a State commission or by local governmental authority.

ACCOUNTS, RECORDS, AND MEMORANDA; DEPRECIATION CHARGES

SEC. 220. (a) The Commission may, in its discretion, prescribe the forms of any and all accounts, records, and memoranda to be kept by carriers subject to this Act, including the accounts, records, and memoranda of the movement of traffic, as well as of the receipts and expenditures of moneys.

(b) The Commission shall, as soon as practicable, prescribe for such carriers the classes of property for which depreciation charges may be properly included under operating expenses, and the percentages of depreciation which shall be charged with respect to each of such classes of property, classifying the carriers as it may deem proper for this purpose. The Commission may, when it deems necessary, modify the classes and percentages so prescribed. Such carriers shall not, after the Commission has prescribed the classes of property for which depreciation charges may be included, charge to operating expenses any depreciation charges on classes of property other than those prescribed by the Commission, or after the Commission has prescribed percentages of depreciation, charge with respect to any class of property a percentage of depreciation other than that prescribed therefor by the Commission. No such carrier shall in any case include in any form under its operating or other expenses any depreciation or

other charge or expenditure included elsewhere as a depreciation charge or otherwise under its operating or other expenses.

(c) The Commission shall at all times have access to and the right of inspection and examination of all accounts, records, and memoranda, including all documents, papers, and correspondence now or hereafter existing, and kept or required to be kept by such carriers, and the provisions of this section respecting the preservation and destruction of books, papers, and documents shall apply thereto. The burden of proof to justify every accounting entry questioned by the Commission shall be on the person making, authorizing, or requiring such entry and the Commission may suspend a charge or credit pending submission of proof by such person. Any provision of law prohibiting the disclosure of the contents of messages or communications shall not be deemed to prohibit the disclosure of any matter in accordance with the provisions of this section.

(d) In case of failure or refusal on the part of any such carrier to keep such accounts, records, and memoranda on the books and in the manner prescribed by the Commission, or to submit such accounts, records, memoranda, documents, papers, and correspondence as are kept to the inspection of the Commission or any of its authorized agents, such carrier shall forfeit to the United States the sum of $500 for each day of the continuance or each such offense.

(e) Any person who shall willfully make any false entry in the accounts of any book of accounts or in any record or memoranda kept by any such carrier, or who shall willfully destroy, mutilate, alter, or by any other means or device falsify any such account, record, or memoranda, or who shall willfully neglect or fail to make full, true, and correct entries in such accounts, records, or memoranda of all facts and transactions appertaining to the business of the carrier, shall be deemed guilty of a misdemeanor, and shall be subject, upon conviction, to a fine of not less than $1,000 nor more than $5,000 or imprisonment for a term of not less than one year nor more than three years, or both such fine and imprisonment: *Provided*. That the Commission may in its discretion issue orders specifying such operating, accounting, or financial papers, records, books, blanks, or documents which may,

after a reasonable time, be destroyed, and prescribing the length of time such books, papers, or documents shall be preserved.

(f) No member, officer, or employee of the Commission shall divulge any fact or information which may come to his knowledge during the course of examination of books or other accounts, as hereinbefore provided, except insofar as he may be directed by the Commission or by a court.

(g) After the commission has prescribed the forms and manner of keeping accounts, records, and memoranda to be kept by any person as herein provided, it shall be unlawful for such person to keep any other accounts, records, or memoranda than those so prescribed or such as may be approved by the Commission or to keep the accounts in any other manner than that prescribed or approved by the Commission. Notice of alterations by the Commission in the required manner of form of keeping accounts shall be given to such persons by the Commission at least six months before the same are to take effect.

(h) The Commission may classify carriers subject to this Act and prescribe different requirements under this section for different classes of carriers, and may, if it deems such action consistent with the public interest, except the carriers or any particular class or classes in any State from any of the requirements under this section in cases where such carriers are subject to State commission regulation with respect to matters to which this section relates.

(i) The Commission, before prescribing any requirements as to accounts, records, or memoranda, shall notify each State commission having jurisdiction with respect to any carrier involved, and shall give reasonable opportunity to each such commission to present its views, and shall receive and consider such views and recommendations.

(j) The Commission shall investigate and report to Congress as to the need for legislation to define further or harmonize the powers of the Commission and of State commissions with respect to matters to which this section relates.

USE OF JOINT BOARDS—COOPERATION WITH STATE COMMISSIONS

SEC. 410. (a) Except as provided in section 409, the Commission may refer any matter arising in the administration of this Act to a joint board to be composed of a member, or of an equal number of members, as determined by the Commission, from each of the States in which the wire or radio communication affected by or involved in the proceeding takes place or is proposed. For purposes of acting upon such matter any such board shall have all the jurisdiction and powers conferred by law upon an examiner provided for in section 11 of the Administrative Procedure Act, designated by the Commission, and shall be subject to the same duties and obligations. The action of a joint board shall have such force and effect and its proceedings shall be conducted in such manner as the Commission shall by regulations prescribe. The joint board member or members for each State shall be nominated by the State commission of the State or by the Governor if there is no State commission, and appointed by the Federal Communications Commission. The Commission shall have discretion to reject any nominee. Joint board members shall receive such allowances for expenses as the Commission shall provide.

(b) The Commission may confer with any State commission having regulatory jurisdiction with respect to carriers, regarding the relationship between rate structures, accounts, charges, practices, classifications, and regulations of carriers subject to the jurisdiction of such State commission and of the Commission; and the Commission is authorized under such rules and regulations as it shall prescribe to hold joint hearings with any State commission in connection with any matter with respect to which the Commission is authorized to act. The Commission is authorized in the administration of this act to avail itself of such cooperation, services, records, and facilities as may be afforded by any State commission.

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Nos. 84-871, 84-889, 84-1054, and 84-1069

In the Supreme Court of the United States

OCTOBER TERM, 1984

Louisiana Public Service Commission, Appellant
v.
Federal Communications Commission and
United States of America

California and Public Utilities Commission
of California, et al., Petitioners
v.
Federal Communications Commission and
United States of America

Public Utilities Commission of Ohio,
et al., Petitioners
v.
Federal Communications Commission and
United States of America

Florida Public Service Commission, Petitioner
v.
Federal Communications Commission and
United States of America

On Appeal And On Petitions For A Writ Of
Certiorari To The United States Court Of Appeals
For The Fourth Circuit

BRIEF OF APPELLANT, THE LOUISIANA PUBLIC SERVICE COMMISSION, AND PETITIONERS, THE PUBLIC UTILITIES COMMISSION OF OHIO, THE OHIO OFFICE OF CONSUMERS' COUNSEL, AND THE FLORIDA PUBLIC SERVICE COMMISSION

[Counsel listed on inside front cover]

A B Letter Service, Inc., 327 Chartres St., New Orleans, La. (504) 581-5555

55

Anthony J. Celebreeze, Jr.
Attorney General of Ohio
Robert S. Tongren
Assistant Attorney General
Counsel of Record
Mary R. Brandt
Assistant Attorney General
Office of the Ohio Attorney General
Public Utilities Section
180 East Broad Street
Columbus, Ohio 43215
Telephone:(614)466-4395

Attorneys for the
Public Utilities
Commission of Ohio

William A. Spratley
Consumers' Counsel
Richard P. Rosenberry
Lawrence F. Barth
Associate Consumers' Counsel
137 East State Street
Columbus, Ohio 43215
Telephone:(614)466-9539

Attorneys for the Ohio Office of Consumers' Counsel

Michael R. Fontham
Counsel of Record
Paul L. Zimmering
Noel J. Darce
Of STONE, PIGMAN, WALTHER, WITTMANN & HUTCHINSON
546 Carondelet Street
New Orleans, Louisiana 70130
Telephone:(504) 581-3200

Marshall B. Brinkley
General Counsel
Louisiana Public Service Commission
Suite 1630
One American Place
Baton Rouge, Louisiana 70825
Telephone:(504) 342-4429

Attorneys for the Louisiana Public Service Commission

William S. Bilenky, Esq.
General Counsel
Counsel of Record
Paul Sexton, Esq.
Associate General Counsel
Florida Public Service Commission
101 East Gaines Street
Tallahassee, Florida 32301
Telephone: (904) 488-7464

Attorneys for the Florida Public Service Commission

QUESTION PRESENTED

May the Federal Communications Commission order State regulatory agencies to increase intrastate rates to further a Federal policy allowing telephone companies faster capital recovery, although the Communications Act reserves jurisdiction over intrastate rates to the States?[1]

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[1] The Virginia State Corporation Commission was the petitioner in the proceeding before the court of appeals. The Federal Communications Commission and United States of America were respondents. The Louisiana Public Service Commission, Public Utilities Commission of Ohio, Office of Consumers' Counsel for the State of Ohio, and Florida Public Service Commission were intervenors supporting the petitioners. The following parties also supported the petitioner:

State of Michigan and Michigan Public Service Commission;
Department of Public Utility Control of the State of Connecticut;
People of the State of California and the Public Utilities
Commission of the State of California;
National Association of Regulatory Utility Commissioners;
Public Service Commission of the District of Columbia;
Arkansas Public Service Commission;
Kansas State Corporation Commission;
Public Service Commission of Wyoming;
Washington Utilities and Transportation Commission;
Department of Public Service of the State of Minnesota;
Arizona Corporation Commission;
Citizens of the State of Florida;
National Association of State Utility Consumer Advocates;
Consumer Advocate of South Carolina;
Iowa State Commerce Commission;
Public Service Commission of Wisconsin;
Public Service Commission of West Virginia;
New York State Department of Public Service; and
Board of Public Utilities of New Jersey.

The intervenors supporting the respondents included:

North American Telephone Association;
American Telephone and Telegraph Company;
Southern Pacific Communications Company;
GTE Service Corporation;
Continental Telecom, Inc.;
United Telephone System, Inc.;
Cincinnati Bell, Inc.;
The Bell Telephone Company of Pennsylvania;
The Chesapeake and Potomac Telephone Company;
The Chesapeake and Potomac Telephone Company of Maryland;
The Chesapeake and Potomac Telephone Company of Virginia;
The Chesapeake and Potomac Telephone Company of West Virginia;
The Diamond State Telephone Company;
Illinois Bell Telephone Company;
Indiana Bell Telephone Company, Inc.;
Michigan Bell Telephone Company;
The Mountain States Telephone and Telegraph Company;
New England Telephone and Telegraph Company;
New Jersey Bell Telephone Company;
New York Telephone Company;
Northwestern Bell Telephone Company;
The Ohio Bell Telephone Company;
Pacific Northwest Bell Telephone Company;
The Pacific Telephone and Telegraph Company;
Bell Telephone Company of Nevada;
South Central Bell Telephone Company;
Southern Bell Telephone and Telegraph Company;
Southwestern Bell Telephone Company; and
Wisconsin Telephone Company.

STATEMENTS OF SUPPORT

The following parties in Docket No. 84-889 have authorized the parties sponsoring this brief to state that the listed parties support the positions advanced here as well as those contained in their own brief: National Association of Regulatory Utility Commissioners, Arkansas Public Service Commission, California and California Public Utilities Commission, Department of Public Utility Control of the State of Connecticut, Public Service Commission of the District of Colunbia, Public Counsel of the State of Florida, Iowa State Commerce Commission, Kansas State Corporation Commission, State of Michigan and Michigan Public Service Commission, Department of Public Service of the State of Minnesota, New York State Department of Public Service, South Carolina Consumer Advocate, Washington Utilities and Transportation Commission, Wisconsin Public Service Commission.

In addition, the parties sponsoring this brief support the positions advanced by the parties in Docket No. 84-889.

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OPINIONS BELOW

The opinion of the court of appeals is reported as *Virginia State Corp. Com'n v. F.C.C.*, 737 F.2d 388 (4th Cir. 1984) (Jurisdictional Statement Appendix ("J. S. App.") at A-1 *et seq.*) This opinion affirmed a ruling of the Federal Communications Commission, which is reported as *Amend. of Part 31*, 92 F.C.C.2d 864 (1983) (J.S. App. at A-24 *et seq.*) The ruling overruled a previous decision of the Commission, reported as *Amend. of Part 31*, 89 F.C.C.2d 1094 (1982) (J.S. App. at A-61 *et seq.*)

JURISDICTION

The Jurisdictional Statement and Petitions for Writs of Certiorari review the relevant dates.[2] The appellate jurisdiction of the Court is invoked in No. 84-871 pursuant to 28 U.S.C. §1254(2); the certiorari jurisdiction is invoked in Nos. 84-889, 84-1054 and 84-1069 pursuant to 28 U.S.C. §1254(1).

The Court postponed the question of jurisdiction in No. 84-871 to the hearing of the case on the merits. That issue is addressed in Section II.

STATUTORY PROVISIONS

The following federal statutes, reprinted commencing at J.S. App. A-131, are involved in this case:

47 U.S.C. §151
47 U.S.C. §152
47 U.S.C. §153(e)
47 U.S.C. §220

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2 Jur. St., No. 84-871, at 3; Pet., No. 84-1054, at 1; Pet., No. 84-1069, at 2. *See also* J. S. App. at A-90 - A-93.

47 U.S.C. §221(b)
47 U.S.C. §221(c)
47 U.S.C. §410

Certain Louisiana State ratemaking orders were invalidated by the *Preemption Decision* of the Federal Communications Commission, as enforced in a Federal court injunction proceeding, and are set forth beginning at J.S. App. A-94.

STATEMENT OF THE CASE

Preliminary statement.

The issue is whether the Federal Communications Commission ("FCC") may require State regulatory commissions to increase intrastate telephone rates, despite express statutory provisions reserving jurisdiction over these rates to the States. The FCC preempted State ratemaking practices that were inconsistent with two of its own accounting orders[3] and mandated the adoption of the Federal procedures in setting intrastate rates.[4] The United States Court of Appeals for the Fourth Circuit affirmed the *Preemption Decision* by a 2-1 majority.[5]

The *Preemption Decision* discarded nearly 50 years

[3] *Amend. of Part* 31, 83 F.C.C.2d 267 (1980); *Amend. of Part 31,* 85 F.C.C.2d 818 (1981).

[4] *Amend. of Part 31,* 92 F.C.C.2d 864 (1983) (hereinafter cited as "*Preemption Decision*"), J. S. App. at A-24.

[5] *Virginia State Corp. Com'n v. F.C.C.*, 737 F.2d 388, 396 (4th Cir. 1984), J.S. App. at A-1, A-17.

of history, in which Federal and State regulatory responsibilities have been divided using a separations process pursuant to the Communications Act. It ordered that rates be increased for plant assigned to State regulation. To justify its action, the FCC characterized a reporting provision in the Communications Act as an authorization for intrastate ratemaking. To assist the Court in understanding the magnitude of the FCC action, this brief will review the regulatory context in which the *Preemption Decision* was issued.

1. Interstate-intrastate separations.

Since prior to passage of the Communications Act,[6] the interstate and intrastate plant and expenses of telephone carriers have been, and continue to be, divided for ratemaking purposes. Purely intrastate plant and expenses are assigned directly to the relevant intrastate jurisdiction.[7] Purely interstate plant and expenses are assigned to the interstate jurisdiction.[8] Jointly used plant and expenses — the investment and costs incurred to serve both interstate and intrastate purposes — are divided using separations factors. These factors are developed by Federal-State Joint Boards, composed of FCC members and representatives of State agencies.[9] The FCC sets interstate toll rates and interstate "access" charges to cover the expenses and provide a return on the investment

[6] *See Smith v. Illinois Bell Telephone Co.*, 282 U.S. 133 (1930).

[7] *See, e.g., 47 C.F.R.* §§67.124(b),(c),(d), 67.125(c), (d), 67.311(b) (1984).

[8] *See* regulations cited in n.7 *supra.*

[9] *See* 47 U.S.C. §410(c).

assigned to the interstate jurisdiction. The State agencies set intrastate rates and charges to cover intrastate expenses and provide a return to intrastate investment.

The separations process emanates from *Smith v. Illinois Bell Tel. Co.,*[10] where this Court mandated the separation of the intrastate and interstate plant and expenses of a telephone company in testing the fairness of an intrastate rate order. The Court ruled that "[t]he proper regulation of rates can be had only by maintaining the limits of state and federal jurisdiction . . . ."[11] It required a reasonable apportionment of the property of the company based on use.[12]

In the Communications Act of 1934, Congress recognized the need to separate the property of carriers for ratemaking. It provided that the FCC could classify the property used for interstate communications.[13] Subsequently, the FCC and State regulators cooperated to develop simple and equitable separations procedures.[14] In 1971, Congress passed the Federal-State Communications Joint Board Act, 47 U.S.C. §410(c), which memorializes procedures previously developed for making jurisdictional

[10]282 U.S 133 (1930).

[11]*Id.* at 149.

[12]*Id.* at 151.

[13]47 U.S.C. §221(c), J.S. App. at A-137.

[14]*See* the Senate Report on the 1971 Federal-State Communications Joint Board Act, enacted as 47 U.S.C. §410(c). S.Rep. No. 92-632, 92d Cong., 1st Sess., *reprinted in* 1971 U.S. Code Cong. & Ad. News 1511, 1512.

separations. Currently about 25 per cent of telephone plant is allocated to the interstate jurisdiction, and about 75 per cent remains in the intrastate jurisdictions.[15]

2. FCC Uniform System of Accounts.

Section 220 of the Communications Act authorizes the FCC to prescribe the form of accounts for certain telephone carriers and requires these carriers to maintain their records as prescribed by the FCC.[16] This section also gives authority to the FCC to prescribe depreciation practices.[17] These provisions permit the FCC to prescribe a uniform basis for *reporting* the financial affairs of carriers, for the benefit of investors, creditors, regulators, management and others.[18] The FCC uniform system of accounts has never been viewed as binding for ratemaking at either the Federal or State level.[19] State agencies often rely on the FCC uniform system, but carriers usually maintain separate intrastate records to accommodate intrastate ratemaking practices.

The purpose of uniform accounting is to require carriers to report their affairs on a comparable basis.[20] The

[15]*See Amend. of Part 67,* 96 F.C.C.2d 781, 785 n.11 (1983).

[16]47 U.S.C. §220(a), (g), J.S. App. at A-133 - A-136. "Connecting carriers" are defined in Section 2(b) (2) of the Act, which excludes them from all FCC regulation except pursuant to Sections 201-205.

[17]47 U.S.C. §220(b), J.S. App. at A-133 - A-134.

[18]*See, e.g., South Cent. Bell Tel. Co. v. Louisiana Pub. Serv. Com'n,* 352 So.2d 964, 981 (La. 1977), *cert. denied* 437 U.S. 911 (1978).

[19]*See Washington Pub. Int. Org. v. Public Serv. Com'n,* 393 A.2d 71, 79-82 (D.C. App. (1978), *cert. denied,* 444 U. S. 926 (1979).

[20]*See Kansas City Southern Ry. Co. v. United States,* 231 U.S. 423, 442 (1913).

FCC argued this point after its uniform system was promulgated in 1935. The uniform system was attacked by a number of telephone companies that were concerned that amounts included in certain accounts, reflecting the difference between the "original cost" of assets and their cost of acquisition to the reporting utility, would be written off. The FCC assured this Court, however, that the reporting of plant costs would not necessarily determine their disposition.[21]

Consistent with the assurances given this Court, the FCC has never regarded the accounting reports as binding even for its own ratemaking. In 1956, when it approved changes in the accounting for certain operating expenses, the FCC stated that the proceeding involved "accounting, not rate making."[22] It added: "[W]e do not intend that this document should be construed as setting forth any opinion concerning the rate-making aspects of the items at issue."[23] In 1979, in a decision that harmonized the ratemaking and accounting treatment of construction work, the FCC stated: "[I]t is well established that accounting prescriptions are, in general, not conclusive as to substantive rights and do not govern the treatment of an account for ratemaking purposes. . . ."[24] Likewise, State courts and agencies have repeatedly held that the FCC

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[21] *American Tel. & Tel. Co. v. United States*, 299 U.S. 232 (1936). *See also* Kripke, *A Case Study in the Relationship of Law and Accounting: Uniform Accounts 100.5 and 107*, 57 HARV. L. REV. 433, 450-51 (1944).

[22] *Amend. of Part 31*, 13 PUR3d 163, 167 (1956).

[23] *Id.* at 168.

[24] *American Tel. & Tel. Co.*, 72 F.C.C.2d 1, 5 (1979) (citations omitted).

uniform system of accounts is not determinative for ratemaking.[25]

State agencies often make ratemaking adjustments to the data reported pursuant to the FCC uniform system. The following adjustments are common, although they differ from uniform accounting prescriptions:

1) Capitalization of interest on short-term construction;
2) Capitalization of research and development costs;
3) Adjustment of depreciation rates;
4) Adjustment of expenses reported by companies, especially those resulting from affiliated transactions.[26]

The FCC has always been aware that many differences exist between its own accounting policies and the ratemaking practices of State agencies. Thus, when the FCC changed its uniform system in 1978 to authorize current earnings on short-term construction work, it stated:

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[25] *E.g., South Cent. Bell Tel. Co. v. Louisiana Pub. Serv. Com'n*, 352 So.2d 964, 981 (La. 1977), *cert. denied*, 437 U.S. 911 (1978); *Citizens v. Florida Pub. Serv. Com'n*, 415 So.2d 1268 (Fla. 1982); *see Washington Pub. Int. Org. v. Public Serv. Com'n*, 393 A.2d 71, 80 (D.C. App. 1978), *cert. denied*, 444 U. S. 926 (1979).

[26] *See State ex rel Southwestern Bell Tel. Co. v. Public Serv. Com'n*, 645 S.W.2d 44, 52-54 (Mo.App. 1983) (short term construction); *South Cent. Bell Tel. Co. v. Louisiana Pub. Serv. Com'n*, 352 So.2d 964, 981 (La. 1977), *cert. denied*, 437 U.S. 911 (1978) (research and development); *Pacific Tel. & Tel. Co. v. Public Util. Com'n*, 401 P. 2d 353, 372-73 (Cal. 1965) (depreciation); *South Cent. Bell Tel. Co. v. Louisiana Pub. Serv. Com'n*, 373 So.2d 478, 487 (La. 1979) (expenses).

"We do not believe, nor is it intended, that the accounting changes adopted in this proceeding impinge upon the ratemaking prerogatives of any state commission. Further, as everyone is aware, different treatment is already given to a number of items for intrastate vs. interstate ratemaking . . . ."[27]

To the extent possible, the State agencies avoid requiring duplicative records.[28] Nevertheless, when ratemaking adjustments are made to accounts of utilities, separate records are often required to facilitate intrastate ratemaking. In some states, such as New York, the regulatory agency prescribes its own system of accounts.[29] The FCC has always acknowledged the need for separate intrastate records. When the FCC adopted its first uniform system of accounts in 1935, its order provided:

> Nothing herein contained shall be construed as prohibiting or excusing any such carrier . . . from subdividing the accounts herein prescribed in the manner ordered by any State commission having jurisdiction or to the extent necessary to secure the information required in the prescribed reports to such commissions.[30]

In 1941, the FCC incorporated a virtually identical provision in its regulations.[31] This provision remains in the Code to this day.

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[27] *Amend. of Part 31,* 68 F.C.C.2d 902, 906 (1978).

[28] Kripke, *supra* n.21 at 438 n.22 (1944).

[29] *See, e.g., Re Accounting Treatment,* 71 PUR3d 440 (N.Y.P.S.C. 1967); 16 N.Y.C.R.R. §660 *et. seq.* Wisconsin also has its own accounting system.

[30] *Accounting Rules for Telephone Companies,* 1 F.C.C. 45, 46 (1935) (Order No. 7-C).

[31] 47 C.F.R 31.01-2(f).

Under the FCC-prescribed uniform system of accounts, companies report their plant and expenses on a combined basis. Intrastate records are developed using the separations process to reflect intrastate operations.[32] To the extent that State ratemaking laws, regulations or requirements differ from accounting policies, and special records are needed for intrastate ratemaking, these subaccounts become part of the intrastate records.[33]

The 1935 uniform system of the FCC contained accounts for depreciation expense and accumulated depreciation, as well as instructions for developing depreciation rates. However, the FCC did not actively enforce its depreciation instructions on interstate plant until the 1940s. During that time, the States were exercising their authority to prescribe depreciation accrual rates for intrastate plant. After the FCC began exercising its authority, both the FCC and the States prescribed depreciation rates for their respective jurisdictions. In an effort to achieve uniformity, the FCC, State commissions and carriers began conducting three-way meetings to negotiate the depreciation rates for each State.[34] Agreements normally have been reached, but because the rates were negotiated, they nearly always have varied from State to State, even for the same company.[35]

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[32] *See* 47 C.F.R. Part 67 (1984).

[33] In States with their own uniform accounting systems, the State records are not really subaccounts, but separate State accounts.

[34] *See Prescription of Revised Percentages of Depreciation,* 88 F.C.C.2d 1223, 1225, 1230-31 (1982).

[35] *Id.* at 1248-1301.

When agreements have not been reached, the State agencies have used State-prescribed depreciation practices for intrastate ratemaking and carriers have maintained separate depreciation records pursuant to these practices.[36]

3. FCC proceedings below.

The FCC issued two orders in 1980 and 1981 to modify the accounting practices prescribed for carriers. In 1980, it amended 47 C.F.R. §31.02-80 to authorize carriers to begin using the "equal life group" and "remaining life" procedures in developing depreciation rates rather than the traditional "vintage group" and "whole life" procedures ("*Depreciation Order*").[37]

The *Depreciation Order* acknowledged that depreciation measures are inherently imprecise and require the exercise of judgment,[38] and that the issues are "complex and not readily characterized as 'right' or 'wrong.' "[39] In approving the equal life group method, the FCC permitted the new method *at the option of the carrier.*[40] The change to the remaining life method was also made optional.[41] The new depreciation methods allowed carriers to record increased depreciation expense on their accounts.

In 1981, the FCC modified the accounting method for station connection costs, requiring the expensing of these costs rather than the traditional capitalization

[36] *See, e.g., Pacific Tel. & Tel. Co. v. Public Util. Com'n,* 401 P.2d 353, 372-73 (Cal. 1965).

[37] *Amend. of Part 31,* 83 F.C.C.2d 267 (1980).

[38] 83 F.C.C.2d at 271, 280.

[39] *Id.* at 280.

[40] *Id.*

[41] *Id.* at 290.

costs rather than the traditional capitalization and depreciation of the expenditures ("*Expensing Order*").[42] This change is similar to the earlier ruling permitting the expensing rather than capitalization of interest on short-term construction.[43]

After the issuance of the *Expensing Order,* petitions were filed with the FCC seeking a clarification that it was not binding on State agencies for intrastate ratemaking.[44] The FCC responded with a decision that "state commissions are not precluded from using their own accounting and depreciation procedures for intrastate ratemaking purpose[s] . . . ."[45] It concluded that Section 220 of the Communications Act does not require State agencies to adhere to FCC-prescribed accounting and depreciation methods. It also ruled that preemption was not necessary to further any Federal policy. The FCC specifically noted that "[m]any states have adopted different accounting practices for intrastate ratemaking than those prescribed by the uniform system."[46]

The FCC reversed itself in its *Preemption Decision.*[47] Acting on petitions filed by telephone carriers, it determined that Section 220(b) of the Communications Act, which required the FCC to prescribe depreciation practices for carriers, precludes the States from departing from FCC depreciation rates in fixing intrastate rates.[48] In reaching its decision, the FCC characterized its *Expensing*

[42] *Amend. of Part 31,* 85 F.C.C.2d 818 (1981).

[43] *Amend. of Part 31,* 68 F.C.C.2d 902 (1978).

[44] *Amend. of Part 31,* 89 F.C.C.2d 1094 (1982), J.S. App. at A-61.

[45] *Id.* at 1095, J.S. App. at A-62.

[46] *Id.* at 1108-09, 1108 n.19, J.S. App. at A-84, A-81 - A-82 n.19.

[47] 92 F.C.C.2d 864 (1983), J.S. App. at A-24.

[48] *See Preemption Decision,* 92 F.C.C.2d at 879, J.S. App. at A-49.

Order as a depreciation decision. Although this ruling required the expensing rather than capitalization of station connection costs, the FCC called it a depreciation ruling because the plant would no longer be depreciable.[49] The FCC did not distinguish prior decisions permitting the expensing rather than capitalization of costs. For example, in its decision on short-term construction work, the FCC disclaimed any intent to bind intrastate ratemakers.[50]

Alternatively, the FCC determined that it would preempt inconsistent State depreciation practices under its general power to further a Federal policy.[51] The FCC concluded that it was necessary to preclude *any* State from applying inconsistent depreciation policies to any plant for intrastate ratemaking.

The Federal "policy" identified by the FCC as served by preemption was a need for faster capital recovery in a "competitive environment" to encourage innovation and better allow carriers "to fully compete in the continually evolving telecommunications marketplace."[52] The alleged analysis of the impact on competition consisted of a series of speculations as to possible consequences of inconsistent State practices. The FCC found that slower capital recovery "could delay or prevent" modernization.[53] It also found that slower capital recovery "could well impair" capital attraction, which then "could undermine" the objective of developing an efficient telecommunications

[49]*Id.* at 868, J.S. App. at A-30 - A-31.

[50]*Amend. of Part 31*, 68 F.C.C.2d 902 (1978).

[51]*Preemption Decision*, 92 F.C.C.2d at 875-78, J.S. App. at A-42 - A-48.

[52]*Id.* at 877, J.S. App. at A-45 - A-46.

[53]*Id.*

market place.[54] The FCC made no empirical analysis quantifying, or even approximating, the effect of its new accounting methods on capital recovery.[57] Nor did the FCC explain why local exchange carriers providing monopoly services, subject to regulation, should be provided capital recovery permitting them to "compete" in the "telecommunications marketplace."[56]

The *Preemption Decision* voided State depreciation rates, policies and accounting practices different from those that carriers were permitted to adopt pursuant to the *Depreciation Order* and *Expensing Order*.[57] The FCC also indicated a belief that *all* Federal accounting and depreciation policies are preemptive.[58] It said: "[W]e will not allow inconsistent accounting or depreciation methods unless such practices are otherwise consistent with the public interest."[59]

The *Preemption Decision* allows carriers to record higher expenses for the expensing of station connections and faster depreciation in many States, and precludes State commissions from adjusting the accounts for intrastate ratemaking. Rate increases are therefore required to match the increased expenses, at least in States where

[54]*Id.* at 877, J.S. App. at A-46.

[55]*See Preemption Decision*, 92 F.C.C.2d at 876-78, J.S. App. at A-46 -A-48.

[56]*See Preemption Decision*, 92 F.C.C.2d at 877, J.S. App. at A-46.

[57]*Id.* at 879, J.S. App. at A-49.

[58]*Id.* at 873-74, J.S. App. at A-39 -A-40.

[59]*Id.* at 873-74, J.S. App. at A-40.

faster capital recovery had not already been allowed.[60] In a number of Federal court enforcement proceedings, the States have been required to grant rate increases to comply with the ruling.[61]

4. Ruling of the court of appeals.

A petition for review of the *Preemption Decision* was filed by the Virginia State Corporation Commission in the court of appeals.[62] A number of States, State regulatory agencies and consumer advocates intervened in support of the petitioner. The court of appeals declined to decide whether the language of the Communications Act requires preemption.[63] Instead, in a 2-1 decision, it ruled that the "regulatory action" of the FCC was justified as "within its authority to ensure efficient operation of the interstate telephone network."[64]

Although the court of appeals recognized that Sections 152(b) and 221(b) of the Communications Act "reserve to the states the authority to prescribe rates for intrastate telephone service,"[65] it determined that these provisions are outweighed by the "primary emphasis upon

[60] In states such as Florida, which have rejected FCC depreciation policy but have other, more generous depreciation policies than the FCC, the affected carriers have not chosen to enforce the *Preemption Decision.*

[61] *E.g., South Central Bell Telephone Co. v. Louisiana Pub. Serv. Com'n.*, 744 F.2d 1107 (5th Cir. 1984); *appeal docketed*, No. 84-870 (U.S., Nov. 30, 1984).

[62] *Virginia State Corp. Com'n v. F.C.C.*, 737 F.2d 388 (4th Cir. 1984), J.S. App. at A-1.

[63] *Id.* at 392, J.S. App. at A-8.

[64] *Id.* at 394, J.S. App. at A-11.

[65] *Id.* at 392, J.S. App. at A-8.

a 'rapid, efficient, Nationwide, and world-wide' communication service."[66] According to the court, this "overriding concern,"[67] which is contained in the "purpose"[68] section of the Communications Act, permits the FCC to override the specific statutory reservation of power to the States.

The court of appeals employed a two-step analysis, based on *Fidelity Fed. Sav. and Loan Ass'n v. de la Cuesta*,[69] in approving preemption. First, it found that the FCC intended to preempt.[70] Second, it found that since the FCC is authorized by Section 220(b) to prescribe depreciation rates, the FCC acted within its power in requiring the States to raise intrastate rates for increased depreciation.[71] In applying the two-step analysis, the court of appeals gave no weight to the statutory provisions reserving ratemaking power to the States. The court of appeals accepted, without scrutiny, the FCC contention that "improper capital recovery does pose a true threat in today's competitive market."[72]

Judge Widener, in dissent, determined that the FCC and the majority had "effectively written 47 U.S.C. §§152(b) and 221(b) out of the Communications Act."[73] He added: "The logical result of this decision is to permit the

[66] *Id.*

[67] *Id.*

[68] 47 U.S.C. §151, J.S. App. at A-131.

[69] 458 U.S. 141 (1982).

[70] 737 F.2d at 393-94, J.S. App. at A-11.

[71] *Id.* at 394, J.S. App. at A-11.

[72] *Id.* at 394, J.S. App. at A-12.

[73] *Id.* at 398, J.S. App. at A-21.

FCC to abrogate completely the state regulation of intrastate ratemaking for the carriers' intrastate operations in violation of the Communications Act."[74] The dissenting judge also observed that the asserted "threat" to competition was mere "theorizing."[75] He noted that the FCC had failed to show the relationship between the capital recovery of regulated monopoly carriers and the competitive abilities of unregulated carriers.[76]

The *Preemption Decision* was interpreted by the United States Court of Appeals for the Fifth Circuit in a proceeding to enforce the FCC ruling.[77] The court upheld an injunction requiring a dollar-specific intrastate rate increase and precluding the Louisiana Commission from adjusting a previously authorized rate of return. The court stated that the "Preemption Order comes perilously close to undermining completely state authority and discretion to set intrastate rates . . . ."[78]

The *Preemption Decision* had a significant impact on intrastate rates. The Louisiana Commission, for instance, was required in the enforcement proceeding to raise intrastate rates by more than $40 million to comply with the decision.[79] In its most recent rate order involving South

[74] *Id.* at 398, J.S. App. at A-22.

[75] *Id.* at 398, J.S. App. at A-20.

[76] *Id.* at 398, J.S. App. at A-20 - 21.

[77] *South Cent. Bell Tel. Co. v. Louisiana Pub. Serv. Com'n,* 744 F.2d 1107 (5th Cir. 1984).

[78] *Id.* at 1121.

[79] *South Cent. Bell Tel. Co. v. Louisiana Pub. Serv. Com'n,* 570 F. Supp. 227 (M.D. La. 1983); *aff'd* 744 F.2d 1107 (5th Cir. 1984).

Central Bell Telephone Company, the Louisiana Commission determined that the *Preemption Decision* required $62.7 million of the total increase in revenues for the company.[80] If the *Preemption Decision* were implemented in Ohio in 1985, the impact on rates charged by the three major telephone companies could be as much as $64 million annually.[81]

The Florida Commission has rejected the equal life group method but nevertheless permits equivalent capital recovery to that prescribed by the FCC. Ironically, since no carrier chooses to enforce the FCC method, Florida depreciation for the present is based on the intrastate ratemaking practice.

ARGUMENT

Summary of the Argument

1. The ruling of the court of appeals approves the conscription of State regulatory officials to raise intrastate telephone rates. The decision is based on an incorrect interpretation of *Fidelity Fed. Sav. and Loan Ass'n v. de la Cuesta*[82] and other preemption decisions of this Court. The analysis of the court of appeals focused on language describing the general purpose of the Communications Act, but gave no weight to provisions reserving intrastate ratemaking to the States. The ruling permits a Federal agency, in pursuit of an agency-created "policy," to override statutory boundary lines and, without authority, displace State law.

2. The *Preemption Decision* requires rate increases to

[80] *Ex parte South Cent. Bell Tel. Co.,* Order No. U-15995-A (La. P.S.C., 1984), J.S. App. at A-112, A-120.

[81] *Re General Tel. Co. of Ohio,* No. 84-1026-TP-AIR (P.U.C. Ohio); *Re Cincinnati Bell Tel. Co.,* No.84-1272-TP-AIR (P.U.C. Ohio); *Re Ohio Bell Tel. Co.,* No. 84-1435-TP-AIR (P.U.C. Ohio).

[82] 458 U.S. 141 (1982).

comport with the new FCC accounting and depreciation policies. Therefore, it conflicts with explicit provisions of the Communications Act. The Act limits the reach of FCC jurisdiction to interstate communications and grants autonomy to the States in regulating intrastate communications. The statute contemplates the separation of the interstate and intrastate plant and expenses of telephone carriers for regulatory purposes. It also recognizes that separate records may be necessary for intrastate accounting and ratemaking. By requiring State agencies to increase rates to conform with Federal accounting and depreciation practices, the FCC has undertaken an unauthorized foray beyond its regulatory jurisdiction and has entered a province reserved to the States by Congress.

3. Section 220 of the Communications Act, which permits the FCC to prescribe a system of accounts for telephone carriers, does not authorize the FCC to order intrastate rate increases. Section 220 was intended to foster uniform *reporting* of the affairs of carriers; it does not require uniform ratemaking. The FCC never previously viewed its accounting prescriptions as binding on the States, or even on itself, for ratemaking. Courts and regulatory agencies have consistently held that uniform accounting practices do not control ratemaking. No basis exists for the attempt by the FCC to transform a *reporting* provision into authority for setting intrastate rates.

4. The legislative history of the Communications Act confirms that Congress intended to preclude the FCC from engaging in intrastate ratemaking. The sponsors of the Communications Act repeatedly stated their intent to preserve State ratemaking autonomy. Congress rejected a version of Section 220(j) that implied that the States were denied the power to prescribe rates. Congress also decided not to include a version specifically reserving State authority, but this section was unnecessary. Ratemaking jurisdiction had already been reserved to the States. In the

final version of Section 220(j), Congress retained the prerogative to enact legislation to harmonize interstate and intrastate accounting. It thus denied the FCC the discretion to preempt State practices.

In addition, five decades of administrative practice confirm the Congressional intent to preserve State ratemaking autonomy. The plant and expenses of carriers have been divided, for ratemaking, in the separations process. The States have always been free to adjust data reported on the accounts of carriers for ratemaking, and dual records, including dual depreciation accounts, have been maintained for decades by carriers to facilitate ratemaking adjustments.

5. Since State ratemaking authority is protected by a federal statute, the only conceivable rationale for approving preemption would be the impossibility of reconciling the limiting provisions with other statutory provisions. The impossibility rationale was the underlying basis for past decisions of lower courts approving preemption by the FCC in other contexts. In this case, it is possible to divide ratemaking responsibilities and they have been divided for decades using the separations process. The division follows the Congressional plan. In addition, the so-called "conflict" identified by the FCC is based wholly on speculation and could not provide a valid basis for ignoring Congressional intent.

6. The Court has jurisdiction of the appeal taken by the Louisiana Commission pursuant to 28 U.S.C. §1254(2), which permits appeals to the Court when State laws are invalidated on Federal constitutional grounds. The decision of the court of appeals affirmed a ruling that invalidates State ratemaking orders, which are considered statutes for the purpose of 28 U.S.C. §1254(2). Therefore, the Court should find that its appellate jurisdiction was properly invoked.

I. THE *PREEMPTION DECISION* IMPROPERLY SUBVERTS THE INTENT OF CONGRESS TO PRESERVE STATE AUTHORITY OVER INTRASTATE TELEPHONE COMMUNICATIONS.

In mandating that State regulators increase intrastate telephone rates to conform to Federal accounting prescriptions, the FCC invaded the authority reserved to the States in the Communications Act. In the statute, Congress expressly prohibited the FCC from regulating intrastate telephone communications and, particularly, intrastate rates. The legislative history and five decades of administrative practice confirm this Congressional intent. Section 220 of the Act, which is a reporting rather than a ratemaking provision, provides no support for the FCC action. Since the separations process provides for the coexistence of Federal and State ratemaking practices, there is no "impossibility" argument for reading away the provisions protecting intrastate authority. Therefore, the *Preemption Decision* is invalid.

The court of appeals purportedly applied the preemption standard announced by this Court in *Fidelity Fed. Sav. and Loan Ass'n v. de la Cuesta*[83] in upholding the *Preemption Decision*. The *de la Cuesta* test for preemption is: first, whether the agency intended to preempt state law; and, second, whether the agency action was within the scope of the agency's delegated authority.[84] However, in mechanically applying this Court's two-part test, the court of appeals ignored the restrictions on FCC jurisdiction contained in the Communications Act, contrary to *de la Cuesta*. Indeed, this Court reaffirmed that the agency must respect boundary lines set by Congress. It held that a

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83 458 U.S. 141 (1982).

84 *Id.* at 154.

preemptive decision should be overruled when " 'it appears from the statute or its legislative history that the [preemption] is not one that Congress would have sanctioned' "[85] or when it is " 'inconsistent with' "[86] the underlying statute. To determine whether the agency had discretion to act as it did, the Court in *de la Cuesta* reviewed the language and legislative history of the statute in question.[87]

Here, the court of appeals was not faithful to this analysis. With respect to the first part of the *de la Cuesta* test, it correctly found that the FCC intended to preempt.[88] With respect to the second part, the court accepted, without question, the FCC's assertion that its action was authorized because it was necessary to further a federal policy.[89] The court of appeals focused on general "purpose" language in the Act, but refused to give meaning to sections preserving State jurisdiction. It also ignored the legislative history of the Act and nearly fifty years of practice. The court found the *Preemption Decision* permissible based on this faulty analysis. The ruling of the court of appeals is deficient because *de la Cuesta* requires respect for Congressional boundary lines.

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85 *Id.*, quoting *United States v. Shimer*, 367 U.S. 374, 383 (1961).

86 *Id.*, quoting *Free v. Bland*, 369 U.S. 663, 668 (1962).

87 *Id.* at 159 *et seq.*

88 737 F.2d at 393, J.S. App. at A-9 - A-10.

89 *Id.* at 395, J. S. App. at A-12 - A-14.

A. The FCC Requirement that State Agencies Increase Intrastate Telephone Rates is Contrary to the Express Statutory Reservation of Intrastate Authority to the States.

The Communications Act specifically precludes the FCC from regulating any aspect of intrastate telephone communication. Section 2(b) of the Act is a broad provision reserving State authority:

> *[N]othing* in this chapter shall be construed to apply or to give the commission jurisdiction with respect to (1) charges, classifications, practices, services, facilities, or regulations for or in connection with intrastate communication service by wire or radio of any carrier . . . .[90]

This language preserves the authority of State agencies over all intrastate charges and intrastate ratemaking practices. Since it appears in the section entitled "APPLICATION OF ACT," it controls all of the provisions granting affirmative authority to the FCC. This provision is the cornerstone of a detailed Congressional plan for dividing Federal and State regulatory authority.[91]

In addition, Congress chose to permit State regulation of certain aspects of interstate communication. Section 3(e), which defines "[i]nterstate communication" and "interstate transmission," and therefore determines that reach of FCC power,[92] states that these terms "shall not . . . include wire or radio communication between points

[90] 47 U.S.C. §152(b), J.S. App. at A-132 (*emphasis added).*

[91] *See* 47 U.S.C. §§203(a), 213(h), 214(a) and 221(a), (c), (d). *See also* 47 U.S.C. §§153(r), (u).

[92] *See* 47 U.S.C. §§151, 152(a), J.S. App. at A-131.

in the same State . . . through any place outside thereof, if such communication is regulated by a State commission."[93] Section 221(b) also reserves jurisdiction to the States over exchange service "subject to regulation by a State commission or by local governmental authority," even when a "portion of such exchange service constitutes interstate or foreign communication."[94]

These provisions establish a clear intent to separate the interstate and intrastate regulatory jurisdictions, and preclude the FCC from regulating intrastate rates. Yet the *Preemption Decision,* when enforced by carriers, requires State regulators to adjust intrastate rates. Since the FCC ruling contravenes the Communications Act, it is not within the preemptive power delegated to the agency.

The *Preemption Decision* runs counter to the statutory provisions for the separation of interstate and intrastate telephone plant and expenses for ratemaking. These provisions provide an administrative mechanism for implementing the separations principle announced by this Court in *Smith v. Illinois Bell Tel. Co.*[95] Section 221(c) of the Act provides that the FCC may "determine what property of [a carrier] shall be considered as used in interstate or foreign telephone toll service."[96] Section 410(c), passed in 1971, provides for joint board proceedings to develop separations procedures.[97] As the Senate Report on the

[93] 47 U.S.C. §153(e), J.S. App. at A-132 - A-133.

[94] 47 U.S.C. §221(b), J.S. App. at A-136 - A-137.

[95] 282 U.S. 133 (1930).

[96] 47 U.S.C. §221(c), J.S. App. at A-137.

[97] 47 U.S.C. §410(c), J.S. App. at A-138 - A-139.

1971 Act stated, the "allocations must be reasonable, i.e., the rate base for each jurisdiction must have appropriate correlation to the different uses of the commonly used plant."[98] Thus, the statute contemplates that the separations process will determine the limits of Federal and State ratemaking jurisdiction pursuant to the mandate of *Illinois Bell.*[99] The *Preemption Decision* violates this division of authority.

The decision of the court of appeals is also contrary to Section 410(b) of the Communications Act, in which Congress expressly contemplated that State commissions would maintain separate records from those of the FCC for ratemaking.[100] This section provides that the Commission may confer with State commissions concerning the relationship of Federal and State rate structures, accounts, practices and classifications and may avail itself of records provided by State commissions. If Congress had intended that only the FCC could require record keeping by telephone carriers, this provision would not have been included in the Act.

The court of appeals circumvented the provisions preserving State authority by focusing primarily on general "purpose" language in Section 151 of the Act. This approach violates established principles of statutory construction. The analysis must involve review of the statutory whole and not the selection of provisions out of context, so that "all parts of a statute, if possible, are to

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[98]S. Rep. No. 92-632, 92d Cong., 1st Sess., *reprinted in* 1971 U.S. Code Cong. & Ad. News 1511, at 1512.

[99]282 U. S. at 149.

[100]47 U.S.C. §410(b), J.S. App. at A-138.

be given effect." *American Textile Mfr. Inst., Inc. v. Donovan.*[101] If an ambiguity appears to exist, each provision should be read as being in harmony with the others, so as not to create a conflict. *Washington Market Co. v. Hoffman.*[102] The provisions should not be read to render the statute partly ineffective or inefficient. *United States v. Powers.*[103]

Applying these principles, the court of appeals misapplied *de la Cuesta.* Congress may have established the general goal "to make available . . . a rapid, efficient, Nation-wide, and world-wide wire . . . communication service . . . ,"[104] but it enacted a dual regulatory system to achieve that goal, reserving intrastate jurisdiction to the States. The court's narrow focus on Section 151 eliminated boundary lines written into other sections. This approach is erroneous, because *de la Cuesta* does not suggest that a court may ignore limiting provisions in a statute.

Although the FCC and the court of appeals referred to Section 220(b) as supporting the *Preemption Decision,*[105] Section 220(b) and the other provisions of Section 220 merely permit the FCC to prescribe methods for *reporting* the financial affairs of carriers. They do not authorize

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[101]452 U.S. 490, 513 (1981).

[102]101 U.S. 112 (1879).

[103]307 U.S. 214, 217 (1983).

[104]47 U.S.C. §151, J.S. App. at A-131.

[105]*Preemption Decision,* 92 F.C.C. 2d at 869-70, J.S. App. at A-31 - A-33; *Virginia State Corp. Com'n v. F.C.C.,* 737 F.2d 388, 394 (4th Cir. 1984), J.S. App. at A-11.

the FCC to set intrastate rates. Therefore, no statutory authorization supports the agency action.

Section 220 was based on Section 20 of the Interstate Commerce Act, which was passed because the accounting systems of carriers had not been uniform. As this Court stated in 1913 in upholding Section 20, Congress "manifested a purpose to standarize and render uniform the accounts of the different carriers." *Kansas City Southern Ry. Co. v. United States.*[106] Section 220 of the Communications Act also was a reporting provision. Indeed, when the FCC initially prescribed its uniform system of accounts pursuant to this section, it assured this Court that the reporting requirements would not necessarily determine the ultimate disposition of assets.[107] Since then, the FCC has consistently maintained that its accounting prescriptions are not binding for ratemaking.[108] As the FCC stated in 1979, it "is well established that accounting prescriptions . . . do not govern the treatment of an account for ratemaking purposes . . . ."[109] In its first ruling on the preemption issue, the FCC acknowledged that administrative agencies and courts uniformly held for four decades that Section 220 does not inhibit State ratemaking prerogatives.[110]

[106]231 U.S. 423, 442 (1913).

[107]*American Tel. & Tel. Co. v. United States,* 299 U.S. 232 (1936).

[108]*Amend. of Part 31,* 13 PUR3d 163, 167 (1956); *American Tel. & Tel. Co.,* 64 F.C.C.2d 1, 56-60, 62, 68 (1977).

[109]*American Tel. & Tel. Co.,* 72 F.C.C.2d 1, 5 (1979).

[110]*Amend. of Part 31,* 89 F.C.C.2d 1094, 1107 (1982), J.S. App. at A-83.

Decisions of State courts and administrative agencies consistently hold that the accounting provisions of the FCC are not binding for intrastate ratemaking. For instance, the District of Columbia Court of Appeals made an extensive analysis of the history of the Communications Act and determined that the uniform accounting system "merely was a system of notation, without substantive significance." *Washington Pub. Int. Org. v. Public Serv. Com'n.*[111] The court held that uniform accounting precepts of federal agencies are not binding for ratemaking. In addition, the Supreme Court of California ruled that the California Commission was "not bound by the depreciation rates or methods set by the Federal Communications Commission." *Pacific Tel. & Tel. Co. v. Public Util. Com'n.*[112]

The Louisiana Supreme Court also has held that the uniform accounts of the FCC are not binding. In upholding a decision to capitalize costs that were expensed under the uniform system, it said: "The fact that capitalization of research costs may not accord with accounting practices prescribed by the F.C.C. does not necessarily render it unreasonable." *South Cent. Bell Tel. Co. v. Louisiana Pub. Serv. Com'n.*[113] The conclusion that federal accounting precepts are not binding for intrastate ratemaking appears to be universally shared by state courts and regulatory agencies.[114]

[111]393 A.2d 71, 80 (D.C. App. 1978), *cert.denied,* 444 U.S. 926 (1979).

[112]401 P.2d 353, 372-73 (1965).

[113]352 So.2d 964, 981 (La. 1977), *cert. denied,* 437 U.S. 911 (1978).

[114]*New England Tel. & Tel. Co. v. Public Util. Com'n,* 448 A.2d 272, 293 (Maine 1982); *State ex rel Southwestern Bell Tel. Co. v. Public Serv. Com'n,* 645 S.W.2d 44, 54-56 (Mo.App. 1983); *Washington Util. and Transp. Com'n v. Pacific Northwest Bell Tel. Co.,* 39 PUR4th 126, 135-36 (Wash. U.T.C., 1980); *Southwestern Bell Tel. Co.,* 36 PUR4th 283, 294 (Mo. P.S.C., 1980); *Re Accounting Treatment,* 71 PUR3d 440, 442 (N.Y. P.S.C., 1967); *Southern Bell Tel. & Tel. Co.,* 66 PUR3d 1, 58 (Fla. P.S.C., 1966).

The federal courts of appeals have recognized the universal regulatory principle that accounting precepts cannot dictate ratemaking in reviewing decisions of the Federal Power Commission and its successor, the Federal Energy Regulatory Commission. In *Alabama-Tennessee Nat. Gas Co. v. F.P.C.*, the Fifth Circuit ruled that the FPC uniform system was a valuable tool, but it "cannot dictate ratemaking policies."[115] The District of Columbia Circuit and the Fourth Circuit have reached similar conclusions.[116]

Section 220 does not authorize the FCC to prescribe ratemaking practices for the States. This provision is designed to bring about uniform reporting, not uniform ratemaking. As a reporting provision, Section 220 is wholly consistent with the sections preserving State ratemaking jurisdiction, especially since Section 221(c) contemplates separation of interstate and intrastate plant for ratemaking and Section 410(b) recognizes that separate State records may be maintained to facilitate intrastate ratemaking.

The reliance on Section 220(b) is also unjustified because Section 220(j) precludes FCC discretion to preempt State depreciation and accounting. It directs the FCC to report to Congress on the need for legislation to harmonize State and Federal powers over accounting and depreciation. Thus, Congress reserved to itself, and denied the FCC, the power to change the relationship of Federal and State authority under Section 220.

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[115] 359 F.2d 318, 336 (5th Cir. 1966).

[116] *Public Systems v. F.E.R.C.*, 606 F.2d 973, 982 (D.C. Cir. 1979) ("[D]espite the obvious relevance of accounting precepts for some regulatory policies, they cannot supply an independent basis for action when they may conflict with established ratemaking principles."); *Consolidated Gas Supply Corp. v. F.E.R.C.*, 653 F.2d 129, 135 (4th Cir. 1981). *See also* A.J.G. PRIEST, PRINCIPLES OF PUBLIC UTILITY REGULATION 611 (1969).

The use of the reporting authorization to force intrastate rate increases produces an especially egregious interference with intrastate prerogatives. Since carriers report *all* their investment and expenses using the FCC uniform system, their accounts include purely intrastate plant, as well as the intrastate portion of jointly used plant. The *Preemption Decision* requires the use of the FCC depreciation methods for ratemaking even with respect to the purely intrastate plant.

The FCC decision to delegate to carriers the right to preempt State ratemaking adds an ironic twist to the subversion of Congressional intent. By giving carriers the option of adopting faster depreciation methods in the *Depreciation Order*, then preempting inconsistent State rules, the FCC allowed the carriers to decide whether State depreciation practices are displaced. This assignment of preemptive power permits the carriers to dictate to State regulators — a result that Congress did not intend. Even if the FCC had preemptive power, the Communications Act does not permit its delegation to the regulated telephone companies.[117]

The cavalier treatment of specific statutory limits by the court of appeals obliterates a premise of preemption theory. In *Garcia v. San Antonio Met. Transit Auth.*,[118] this Court examined affirmative limits on Congressional power under the Commerce Clause.[119] It found that "the principal and basic limit on the federal commerce power is

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[117] *Cf. Greene County Plan. Bd. v. F.P.C.*, 455 F.2d 412, 420 (D.C. Cir. 1972), *cert. denied*, 409 U.S. 849 (1972).

[118] 105 S.Ct. 1005 (1985).

[119] U. S. Const. art. I, §8.

that inherent in all congressional action — the built-in restraints that our system provides through state participation in federal governmental action."[120] Thus, a true implementation of Congressional intent is critical in order to afford States the procedural safeguards upon which *Garcia* rests. If the FCC is permitted to read away limiting provisions of the Act, then the basic safeguard for State authority has been eliminated.

The *Preemption Decision* is an unauthorized usurpation of the authority reserved by Congress to the States. Congress contemplated that Federal and State ratemaking authority would be divided using the separations process, and that the FCC should not invade the intrastate realm. The Act contains no affirmative authority for overriding the Congressional scheme. Therefore, the ruling should be reversed.

B. The Legislative History of the Communications Act and the History of Its Implementation Confirm Congressional Intent to Limit the Jurisdiction of the FCC and Preserve State Autonomy Over Intrastate Communications.

In preemption cases the Court has looked to legislative history to determine the intent of Congress.[121] Had the court of appeals analyzed the legislative history, this review would have shown that Congress intended to preclude the FCC from engaging in intrastate ratemaking.

[120]105 S.Ct. at 1020.

[121]*Fidelity Fed. Sav. and Loan Ass'n v. de la Cuesta*, 458 U.S. 141, 163-67 (1982).

The legislative history of the Communications Act of 1934 demonstrates that Congress had a clear, unequivocal intent to limit FCC authority and preserve State autonomy over intrastate communications. Indeed, the foremost concern of Congress in enacting Title II of the Act was the division of Federal and State authority. This one aspect of telephone regulation received more attention than any other during hearings, in reports and during floor debates. With respect to Section 220, the legislative history demonstrates that Congress did not intend to preempt State authority over accounting or depreciation rates. It intended that any conflict between Federal and State authority be resolved by legislation. Fifty years of administrative practice, in which FCC accounting practices were never seen as binding for intrastate ratemaking, confirm the workability of the Congressional plan.

Bills introduced in both the House and Senate contained provisions limiting FCC authority and preserving State autonomy over intrastate communications.[122] These provisions were apparently drafted with the aid of representatives of State regulatory agencies.[123] The central limiting provisions were ultimately enacted as Sections 2(b) and 221(b) of the Act. These sections reserve to the States all authority to regulate intrastate communications and were strongly supported during committee hearings.

[122]The bills were designated S. 2910 and H.R. 8301. The limiting provisions in S. 2910 were contained in sections 2, 3(e), 210, 220(j) and 221(a)(b)(c) & (d). The limiting provisions in H.R. 8301 were contained in Sections 2, 3(e), 210, 214(e), 220(j) and 221(a)(b)(c) & (d).

[123]See statement of Chairman Dill, Hearings on S. 2910 before the Senate Committee on Interstate Commerce, 73d Cong., 2d Sess. ("Sen. Comm. Hearings") at 179 (1934).

Representatives of the National Association of Railroad and Utility Commissioners ("NARUC") appeared on behalf of State regulatory agencies and urged passage of the bills with the limiting language intact.[124] The States were concerned that a new commission would effectively eliminate meaningful regulation by the States, if it exerted the broad authority of the ICC without limiting provisions.

NARUC emphasized that the States were not wedded to any specific language, but advocated language that would prevent their authority from being eroded.[125] The independent telephone companies supported the provisions limiting FCC authority and, in addition, proposed that local telephone companies carrying interstate calls only via connection to the Bell network, be exempted from FCC authority.[126]

There was little controversy over the proposed division of Federal and State authority. AT&T briefly urged a simple transfer of authority from the ICC to the new Commission.[127] The Senate Committee received suggestions that S. 2910 should be amended to expressly extend FCC authority to the entire communications network.[128] In written comments, a representative of the ICC advised

[124] *See* Statements of Messrs. Benton, Clardy and McDonald, Sen. Comm. Hearings at 153-155, 155-157 and 178-184; Hearings on H.R. 8301 before the House Committee on Interstate and Foreign Commerce, 73rd Cong., 2d Sess. ("H.R. Comm. Hearings"), at 70-74, 131-147 (1934).

[125] Sen. Comm. Hearings at 154-55, 179-80; H.R. Comm. Hearings at 71, 73, 136, 132.

[126] *See* comments of Messrs. MacKinnon, Derring, Hedreck, and McKinney, H.R. Comm. Hearings at 239, 241, 248, 252, 254 and 273.

[127] *See* Sen. Comm. Hearings at 77, 213-16.

[128] *See* Comments of Messrs. McDonough and Nockels, Sen. Comm. Hearings at 114-16, 199.

that subsection 221(b) might result in ineffective interstate regulation.[129] However, both committees and, ultimately, both houses of Congress agreed to the division of Federal and State authority as proposed and adopted provisions that further limited FCC authority.

The Senate Committee on Interstate Commerce endorsed the division of Federal and State authority and rejected the simple transfer of authority from the ICC.[130] Its report noted that Section 2 of the bill reserved exclusive State jurisdiction over intrastate communication.[131] On the Senate floor, Senator Dill emphasized that the bill *preserved* State authority to regulate intrastate communications.[132]

The House report also endorsed the division of Federal and State authority in H.R. 8301.[133] Among other things, the House report noted that subsection 2(b) exempts the intrastate business of any carrier.[134] On the House floor, Representative Rayburn noted that the bill preserved State authority over intrastate communications.[135] H.R. 8301 was passed by the House without amendment as a substitute for S. 3285.[136]

[129] Sen. Comm. Hearings at 209, H.R. Comm. Hearings at 97.

[130] S.Rep. No. 781, 73rd Cong., 2d Sess., at 1-2 (1934) ("S.Rep."). The report proposed to substitute S. 3285 in favor of S. 2910, but retained the division of authority in S. 2910.

[131] S.Rep. at 3.

[132] 78 Cong. Rec. 8823 (1934).

[133] *Id.* at 8846. One amendment changed subsection 2(h) to further exempt local companies that carried interstate calls only by connection to carriers with which they were not affiliated.

[134] H.R. Rep. No. 1850, 73rd Cong., 2d Sess. (1934) ("H.R. Rep.").

[136] 78 Cong. Rec. 10313, 10314 (1934).

A conference committee was authorized to settle the differences between S. 3285 and H.R. 8301. As ultimately proposed by the conference committee and approved by each House, the Act contained ten provisions that limited FCC jurisdiction and preserved State autonomy over intrastate communications.[137]

Congress fully and carefully considered the scope of FCC authority and intended to limit FCC authority in favor of State autonomy over intrastate and local communication. The decision of the court of appeals flies in the face of the clear intent of Congress that the FCC could not preempt any State regulation of intrastate communication that simply affects an FCC interstate policy. Had Congress intended to permit the FCC to supercede State regulation, it would have simply transferred the ICC's power to the FCC. Instead, it explicitly preserved State autonomy.

Congress understood that State regulation would affect federal policy. That is the very basis of the *Shreveport Rate Case,* where intrastate rates were raised to the level prescribed by the ICC to avoid discrimination.[138] In enacting provisions to insulate State regulation and prevent a Federal determination of intrastate rates, Congress overruled the *Shreveport Rate Case.*[139] Congress' thoughtful, deliberate decision to permit a diverse array of regulatory policies belies any intent to permit preemption of State regulation to advance an agency policy.

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[137]These provisions were contained in subsections 2(b) (1), 2(b) (2), 3(e), 203(a), 213(h), 214(a) and 221(a)(b)(c) and (d).

[138]*Houston, E. & W. Texas Ry. v. United States,* 234 U.S. 342 (1914).

[139]*See North Carolina Util. Com'n v. F.C.C.,* 552 F. 2d 1036, 1047 (4th Cir.1977), *cert. denied,* 434 U.S. 874 (1977).

The *Preemption Decision* also conflicts with the legislative history of Section 220. As originally drafted, subsections (h)-(j) of Section 220 explicitly preserved State autonomy over systems of accounts and depreciation. NARUC endorsed subsection (j), which preserved State discretion to prescribe depreciation rates and forms of accounts, but did not urge adoption of its specific terms. The States sought language preserving their authority to obtain data needed for intrastate purposes and to review a carrier's depreciation rates when setting intrastate rates.[140]

AT&T vigorously attacked subsections (h) and (j). It urged that subsection (h) would permit the FCC to dismantle the existing uniform system of accounts and that subsection (j) would create an impossible situation for multistate companies.[141] AT&T never contended, however, that the States should be limited in their ability to obtain data or hindered in their intrastate ratemaking.[142] In written comments, a representative of the ICC advised that subsection (j) conflicted with the uniformity of systems of accounts and depreciation accounting required by subsection 220.[143]

NARUC, on the other hand, merely sought to ensure that the States could obtain data in addition to the FCC uniform system of accounts. It never endorsed multiple systems of accounts. In fact, it predicted that State participation under subsection (i) would lead to a uniform system that would fulfill many of the needs of the States. As far as depreciation was concerned, NARUC really only

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[140]H.R. Comm. Hearings at 138, 144, 143.

[141]*See* Sen. Comm. Hearings at 96, H.R. Comm. Hearings at 191.

[142]*See* comments of Walter S. Gifford, Sen. Comm. Hearings at 94-97; H.R. Comm. Hearings at 189-92.

[143]Sen. Comm Hearings at 208; H.R. Comm. Hearings at 96.

sought assurance that the States would remain unhindered in reviewing depreciation rates for intrastate ratemaking. The ICC had never prescribed depreciation rates for any telephone company. Instead, the individual States had been doing it, without any complaint from AT&T.[144]

In sum, AT&T sought uniform accounting and NARUC agreed to uniform accounting. Likewise, NARUC sought independent accounting and ratemaking authority and AT&T endorsed subaccounts which allow that. The States were reviewing depreciation rates and AT&T did not suggest that this practice should be prohibited.

The Senate rejected subsections (h) and (j) as drafted and amended those provisions to instruct the FCC to make further recommendations as to whether Congress should pass legislation to *permit* the State commissions to prescribe their own accounting and depreciation practices. On the other hand, the House retained the original language of subsections 220(h) and (j). The Conference Committee sided with the House on subsection (h) and rejected both versions of subsection (j) in favor of a modified version:

> The Commission shall investigate and report to Congress as to the need for legislation to define further or harmonize the powers of the Commission and of State Commissions with respect to matters to which this section relates.[145]

The final version of subsection (j) retains the Senate's direction that the FCC report on the need for legislation. However, it omits the language in the Senate's version suggesting that Section 220 preempts as a matter

[144] *See* H.R. Comm. Hearings at 140-44.

[145] 47 U.S.C. §220(j), J.S. App. at A-136.

of law. Further, the section implies that the States may exercise "powers" with respect to accounting and depreciation. Had Congress intended to withhold State authority it would have adopted subsection (j) as passed by the Senate. Instead, the Conference Committee intended that State and Federal authority over accounting and depreciation be harmonized so that both interests could be preserved.

The Conference Committee had every reason to expect a harmonious exercise of FCC and State powers under a uniform system of accounts that accommodated the needs of the States. Subsection (i) required the FCC to receive and consider State commission comments, no doubt so that its uniform system would require data sought by the States or accommodate additional State requirements. Different accounting requirements, including different depreciation rates, could be accommodated in subaccounts. Nevertheless, since the system was as yet untried, subsection 220(j) directed the FCC to report on the need for legislation to further define or harmonize Federal and State powers over accounting and depreciation.

The intent of Congress to protect intrastate ratemaking authority is confirmed by almost 50 years of administrative practice. In implementing Section 220 of the Act, the FCC officially acknowledged and approved the practice of maintaining separate records for intrastate accounting and ratemaking.[146] Prior to the issuance of the *Preemption Decision*, the FCC had consistently acknowledged that its accounting provisions were not binding on the States for ratemaking.[147] The same conclusion

[146] *Accounting Rules for Telephone Companies*, 1 F.C.C. 45 (1935).

[147] *See supra* notes 107-10 and accompanying text.

was reached by State courts and agencies.[148] This history is strong evidence of Congressional intent, as this Court held in *BankAmerica Corp. v. United States.*[149]

This Court recognized that the failure of an agency to assert its authority is not determinative of the agency's lack of authority, but " 'failure to use such a power for a long time indicates to us that the commission did not believe the power existed.' "[150] When this non-exercise of power was combined with a consistent interpretation by informed agencies over an extended span that the power did not exist, the interpretation was given "powerful weight."[151]

The legislative history of the Federal-State Communications Joint Board Act, passed in 1971, shows that Congress was well aware of the historic development of dual regulation and the use of the separations process to define the limits of Federal and State ratemaking authority. The Senate Report on the Act states: "[F]or each jurisdiction effectively to exercise its authority, procedures are needed to apportion the costs for services under each jurisdiction."[152] Congress knew that the States prescribed ratemaking practices for plant allocated to intrastate jurisdictions. It implicity approved the continuation of this practice.

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148 See *supra* notes 111-14 and accompanying text.

149 103 S.Ct. 2266 (1983).

150 *Id.* at 2272, quoting *Federal Power Com'n v. Panhandle Eastern Pipe Line Co.,* 337 U.S. 498, 513 (1949).

151 103 S.Ct. 2272.

152 S. Rep. No. 92-632, 92d Cong., 1st Sess., *reprinted in* 1971 U.S. Code Cong. & Ad. News 1511 at 1512.

The legislative history of the Communications Act, including Section 220, confirms the intent to preserve State ratemaking authority. Congress recognized that the States would require records for intrastate ratemaking and declined to withhold that authority. It reserved to itself — not to the FCC — the power to legislate further in the area. Fifty years of administrative history establish that the FCC never believed it could set intrastate rates. Therefore, the *Preemption Decision* conflicts with Congressional intent.

C. The Alleged Conflict Between the FCC Policy and State Law Does Not Justify the Evisceration of Statutory Limits on FCC Jurisdiction.

The FCC and the court of appeals referred to a conflict between the Federal policy and State laws and practices to justify the *Preemption Decision.*[153]In this respect, they misapplied the preemption analysis embodied in *de la Cuesta.* In that case, this Court analyzed whether a *valid* federal regulation could coexist with State provisions and, finding a conflict, invalidated the State practices.[154] A conflict analysis is not relevant, however, when Congress explicitly sanctions the exercise of State power.[154] In this case, the actual "conflict" is between an FCC policy and explicit limits contained in the Communications Act. The only conceivable rationale for reading out these limiting provisions would be the *impossibility* of reconciling *statutory* provisions.

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153 *Preemption Decision,* 92 F.C.C.2d at 877, J.S. App. at A-95 - A-96; *Virginia State Corp. Com'n v. F.C.C.,* 737 F.2d at 395, J.S. App. at A-14 - A-15.

154 *Fidelity Fed. Sav. and Loan Ass'n v. de la Cuesta,* 458 U.S. 141, 155-60 (1982).

The impossibility of dual regulation is, indeed, the underlying basis for the few lower court decisions finding that FCC regulations preempted conflicting State provisions. These rulings arose in circumstances not anticipated by Congress. The courts in these cases were faced with the task of reconciling Sections 152(a) and (b), which divide Federal and State regulatory authority. As the courts recognized, circumstances exist where this division is physically impossible. In these cases, either the FCC or the States must have exclusive authority. In each case, the courts determined that preemption was necessary because the continued existence of the intrastate regulations would curb the affirmative power of the FCC over interstate communications.

For instance, in *North Carolina Utilities Com'n v. F.C.C. ("NCUC")*,[156] the Federal and State tariffs contained conflicting provisions for the *physical* interconnection of jointly used equipment. Since the equipment could not be separated in the physical sense, reconciliation of the competing regulations was impossible. Similarly, in *Computer and Comm. Ind. Ass'n v. F.C.C.*,[157] the State laws and Federal regulations conflicted as to whether certain types of equipment could be regulated at all. The equipment could not be broken into its interstate and intrastate components, so the court approved preemption.

In contrast to the line of cases arising from *NCUC*, it is possible to accommodate the statutory provisions in this case. There is no conflict between the provisions allocating authority over the subject matter. Federal and

[156]537 F.2d 787 (4th Cir. 1976), *cert. denied*, 429 U.S. 1027 (1976).

[157]693 F.2d 198 (D.C. Cir. 1982), *cert. denied*, 461 U.S. 938 (1983).

State ratemaking responsibilities have been divided for decades through the separations process — a procedure mandated by this Court in *Smith v. Illinois Bell Tel. Co.*[158] and expressly sanctioned by Congress.[159] The court of appeals conceded that differing Federal and State accounting and ratemaking policies can coexist.[160] By intruding into the realm of intrastate ratemaking and requiring rate changes for plant allocated to the State jurisdiction, the FCC crossed a dividing line established by Congress.

Even if the FCC could overrule the division of authority in the Act by creating a new policy that conflicts with State law, it failed to demonstrate how its policy in this case will be furthered by the *Preemption Decision*. The asserted connection between the capital recovery of regulated, monopoly companies — which generally do not engage in competition — and effective competition in the telecommunications market place has never been established by the FCC and has no apparent logical basis. A mere eight months before the issuance of the *Preemption Decision*, the FCC had issued a well-reasoned analysis of the historical compatibility of simultaneous State and Federal regulation of the telephone industry. It concluded that there was no necessity to preempt.[161] Little weight should be given to the FCC's finding of a conflict in light of its abrupt reversal of position at the urging of regulated companies.

[158]282 U.S. 133 (1930).

[159]47 U.S.C. §§221(c), 410(c).

[160]737 F. 2d at 395, J.S. App. at A-15.

[161]*Amend. of Part 31*, 89 F.C.C.2d 1094 (1982), J.S. App. at A-61.

The decision of the court of appeals approves an attempt to rewrite the Communications Act. Moreover, the "purpose" analysis of the court of appeals is especially objectionable because it gives the FCC license to ignore all statutory limits to its authority over intrastate communication. If the FCC can preempt here under the aegis of Section 151, despite the specific reservation of State authority, then all ratemaking matters are open to FCC usurpation, as long as the issue arguably may foster the goals stated in Section 151.[162] But the FCC is bound by limits prescribed by Congress. As the court of appeals for the District of Columbia Circuit recently stated in a slightly different context, "we are not at liberty to release the agency from the tie that binds it to the text Congress enacted."[163] No matter how strongly the FCC desires to preempt State jurisdiction, Congress has not given it that authority and the FCC cannot assert what it does not have.

II. THIS COURT HAS APPELLATE JURISDICTION OF THE APPEAL PURSUANT TO 28 U.S.C. §1254(2).

This Court has jurisdiction over the decision of the court of appeals pursuant to 28 U.S.C. §1254(2), which permits appeals to this Court when State laws are invalidated as repugnant to the United States Constitution. The decision of the court of appeals affirmed a ruling that invalidates State ratemaking orders. The *Preemption Decision* has been interpreted in a Federal court enforcement proceeding as expressly invalidating ratemaking orders of the Louisiana Commission. The Federal court interpreted the decision as a "direct order . . . specifically declaring

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[162] 737 F.2d at 398, J.S. App. at A-21 (Widener, J., dissenting).

[163] *M.C.I. Telecomm. Corp. v. F.C.C.*, No. 85-1030 (D.C. Cir., July 9, 1985) at 4.

that inconsistent State prescribed depreciation rates are void."[164] The enforcement decision invalidated the State ratemaking orders on a constitutional ground: that they were preempted.[165]

Ratemaking orders of a legislative nature are State "statute[s]" for the purpose of 28 U.S.C. §1254(2).[166] Article 4, Section 21 of the Louisiana Constitution invests the Louisiana Commission with general regulatory authority over common carriers and public utilities. The ratemaking function of the Louisiana Commission is legislative.[167]

The *Preemption Decision* invalidates State laws on constitutional grounds. Congress intended that this Court have appellate jurisdiction to ensure that State laws are not deemed unconstitutional without review by the highest Federal court. Therefore, the Court has jurisdiction over the appeal of the Louisiana Commission. Alternatively, the Court should treat the appeal papers as a petition for certiorari pursuant to 28 U.S.C. §2103.

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[164] *South Cent. Bell Tel. Co. v. Louisiana Public Serv. Com'n*, 570 F. Supp. 227, 236 (M.D.La. 1983), *aff'd* 744 F.2d 1107 (5th Cir. 1984).

[165] 570 F.Supp. at 231-32; 744 F.2d at 1121.

[166] *E.g., Atchinson T. & S. F. Ry Co. v. Public Util. Com'n*, 346 U.S. 346, 348 (1953); *Lake Erie & Western R. Co. v. State Public Util. Com'n*, 249 U.S. 422, 424 (1919).

[167] *E.g., Gulf States Util. Co. v. Louisiana Pub. Serv. Com'n*, 364 So. 2d 1266, 1268 (La. 1978); *South Central Bell Tel. Co. v. Louisiana Pub. Serv. Com'n*, 352 So.2d 964, 969, (La. 1977), *cert. denied*, 437 U.S. 911 (1978).

CONCLUSION

The conscription of State regulatory officials to further a Federal policy by increasing intrastate telephone rates is unjustified. The *Preemption Decision* defies the express reservation of intrastate jurisdiction in the Communications Act, cuts deeply into the sovereignty of the States, and overturns more than five decades of regulatory precedent and practice. The preemption of State ratemaking practices is unnecessary because interstate and intrastate ratemaking functions are separable, and indeed have been separated for decades. Therefore, the Court should reverse the decision of the court of appeals, overturn the *Preemption Decision*, and reaffirm the autonomy of the States in setting intrastate telephone rates.

Respectfully submitted,

Anthony J. Celebreeze, Jr.
Attorney General of Ohio
Robert S. Tongren
Assistant Attorney General
Counsel of Record
Mary R. Brandt
Assistant Attorney General
Office of the Ohio Attorney General
Public Utilities Section
180 East Broad Street
Columbus, Ohio 43215
Telephone:(614)466-4395

Attorneys for the Public Utilities Commission of Ohio

William A. Spratley
Consumers' Counsel
Richard P. Rosenberry
Lawrence F. Barth
Associate Consumers' Counsel
137 East State Street
Columbus, Ohio 43215
Telephone:(614)466-9539

Attorneys for the Ohio Office of Consumers' Counsel

Michael R. Fontham
Counsel of Record
Paul L. Zimmering
Noel J. Darce
Of STONE, PIGMAN, WALTHER, WITTMANN & HUTCHINSON
546 Carondelet Street
New Orleans, Louisiana 70130
Telephone:(504) 581-3200

Marshall B. Brinkley
General Counsel
Louisiana Public Service Commission
Suite 1630
One American Place
Baton Rouge, Louisiana 70825
Telephone:(504) 342-4429

Attorneys for the Louisiana Public Service Commission

William S. Bilenky, Esq.
General Counsel
Counsel of Record
Paul Sexton, Esq.
Associate General Counsel

Florida Public Service Commission
101 East Gaines Street
Tallahassee, Florida 32301
Telephone: (904) 488-7464

Attorneys for the Florida Public Service Commission

(15) (15) (13) (13)

Nos. 84-871, 84-889, 84-1054, and 84-1069

IN THE

Supreme Court of the United States

OCTOBER TERM, 1984

LOUISIANA PUBLIC SERVICE COMMISSION, APPELLANT
vs.
FEDERAL COMMUNICATIONS COMMISSION AND
UNITED STATES OF AMERICA

CALIFORNIA AND PUBLIC UTILITIES COMMISSION
OF CALIFORNIA, ET AL., PETITIONERS
vs.
FEDERAL COMMUNICATIONS COMMISSION AND
UNITED STATES OF AMERICA

PUBLIC UTILITIES COMMISSION OF OHIO,
ET AL., PETITIONERS
vs.
FEDERAL COMMUNICATIONS COMMISSION AND
UNITED STATES OF AMERICA

FLORIDA PUBLIC SERVICE COMMISSION, PETITIONER
vs.
FEDERAL COMMUNICATIONS COMMISSION AND
UNITED STATES OF AMERICA

On Appeal and On Writs of Certiorari to the United States Court of Appeals for the Fourth Circuit

JOINT APPENDIX

Notice of Appeal in No. 84-871 Filed November 27, 1984; Petitions For a Writ of Certiorari in Nos. 84-889, 84-1054, and 84-1069 Filed on December 10, 1984, January 10, 1985, and January 10, 1985, Respectively.

Certiorari Granted June 24, 1985.

(Continued on Inside Front Cover)

BOWNE OF SAN FRANCISCO, INC. • 190 NINTH ST. • S.F., CA 94103 • (415) 864-2300

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MICHAEL R. FONTHAM
Counsel of Record
PAUL L. ZIMMERING
NOEL J. DARCE
OF STONE, PIGMAN,
WALTHER, WITTMANN
& HUTCHINSON
546 Carondelet Street
New Orleans, LA 70130
Telephone: (504) 581-3200

MARSHALL B. BRINKLEY
General Counsel
LOUISIANA PUBLIC SERVICE
COMMISSION
Suite 1630
One American Place
Baton Rouge, LA 70825
Telephone: (504) 342-4429

Attorneys for the Louisiana Public Service Commission

JANICE E. KERR*
General Counsel
J. CALVIN SIMPSON
Assistant General Counsel
GRETCHEN DUMAS
Principal Counsel
PEOPLE OF STATE OF
CALIFORNIA AND
THE PUBLIC UTILITIES
COMMISSION OF THE
STATE OF CALIFORNIA
350 McAllister Street
San Francisco, CA 94102
**Counsel of Record*
Telephone:
(415) 557-0470

CHARLES FRIED
Acting Solicitor General
DEPARTMENT OF JUSTICE
Washington, D.C. 20530
(202) 633-2217

JACK D. SMITH
General Counsel
DANIEL M. ARMSTRONG
Associate General Counsel
JOHN E. INGLE
Deputy Associate General Counsel
FEDERAL COMMUNICATIONS
COMMISSION
Washington, D.C. 20554

Frank J. Kelley
Attorney General
Louis J. Caruso
Solicitor General
Don L. Keskey
Leo H. Friedman
Assistant Attorney General
The State of Michigan and Michigan Public Service Commission
1000 Long Boulevard, Suite 11
Lansing, MI 48910

Lynda S. Mounts
Stuart J. Bassin
Cadwalader, Wickersham & Taft
1333 New Hampshire Ave., N.W.
Washington, D.C. 20036
Of Counsel

David D. Blabey
General Counsel
Lawrence G. Malone
Counsel
Department of Public Service of the State of New York
Three Empire State Plaza
Albany, NY 12223

William Paul Rodgers, Jr.
General Counsel
Charles D. Gray
Assistant General Counsel
Genevieve Morelli
Deputy Assistant General Counsel
National Association of Regulatory Utility Commissioners
1102 ICC Building
Post Office Box 684
Washington, D.C. 20044

Joel B. Shifman
Attorney
Public Service Commission of West Virginia
State Capitol
Charleston, WV 25323

Jack Shreve
Office of the Public Counsel
202 Blount Street, Room 624
Tallahassee, FL 32301

Jack Shreve
National Association of State Utility Consumer Advocates
202 Blount Street, Room 624
Tallahassee, FL 32301

STEVEN W. HAMM
Consumer Advocate for the State of South Carolina
RAYMON E. LARK, JR.
Assistant Consumer Advocate
SOUTH CAROLINA DEPARTMENT OF CONSUMER AFFAIRS
2801 Devine Street
P.O. Box 5757
Columbia, SC 29250

CHRISTOPHER K. SANDBERG
Special Assistant Attorney General
MINNESOTA DEPARTMENT OF PUBLIC SERVICE
1100 Bremer Tower
Seventh & Minnesota
St. Paul, MN 55101

PHILLIP STOFFREGEN
General Counsel
PATRICK NUGENT
Deputy Counsel
DAVID LYNCH
Deputy Counsel
IOWA STATE COMMERCE COMMISSION
Lucas State Office Building
Des Moines, IA 50319

BRIAN MOLINE
General Counsel
DONALD LOW
Counsel
KANSAS STATE CORPORATION COMMISSION
State Office Building
Topeka, KS 66612

HOWARD C. DAVENPORT
General Counsel
LLOYD N. MOORE, JR.
MOORE & HICKS
1250 Eye Street, N.W. No. 201
Washington, D.C. 10005
Attorneys for Public Service Commission of the District of Columbia

STEVEN M. SCHUR
Chief Counsel
WISCONSIN PUBLIC SERVICE COMMISSION
Post Office Box 7854
Madison, WI 53707

ROBERT WALDRUM
Attorney
ARKANSAS PUBLIC SERVICE COMMMISSION
1000 Center
P.O. Box C-400
Little Rock, AR 72202

KENNETH O. EIKENBERRY
Attorney General
LARRY V. ROGERS
Assistant Attorney General
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION
Highways-Licenses Building
Olympia, WA 98504

IRWIN I. KIMMELMAN
Attorney General of New Jersey
By CARLA VIVIAN BELLO
Deputy Attorney General for the NEW JERSEY BOARD OF PUBLIC UTILITES
Division of Law
1100 Raymond Blvd., No. 316
Newark, NJ 07102

JOSEPH I. LIEBERMAN
Attorney General
WILLIAM B. GUNDLING
Assistant Attorney General
PETER J. JENKELUNAS
Assistant Attorney General
PHYLLIS E. LEMELL
Assistant Attorney General
DEPARTMENT OF PUBLIC UTILITY CONTROL/ STATE OF CONNECTICUT
1 Central Park Plaza
New Britain, CT 06051

ANTHONY J. CELEBREEZE, JR.
Attorney General of Ohio
ROBERT S. TONGREN
Assistant Attorney General Counsel of Record
MARY R. BRANDT
Assistant Attorney General
OFFICE OF THE OHIO ATTORNEY GENERAL
Public Utilities Section
180 East Broad Street
Columbus, OH 43215
Telephone: (614) 466-4395

Attorneys for the Public Utilities Commission of Ohio

WILLIAM A. SPRATLEY
Consumers' Counsel
RICHARD P. ROSENBERRY
LAWRENCE F. BARTH
Associate Consumers' Counsel
THE OHIO OFFICE OF CONSUMERS' COUNSEL
137 East State Street
Columbus, OH 43215
Telephone: (614) 466-9539

Attorneys for the Ohio Office of Consumers' Counsel

WILLIAM S. BILENKY, Esq.
General Counsel
Counsel of Record
PAUL SEXTON, Esq.
Associate General Counsel
FLORIDA PUBLIC SERVICE
COMMISSION
101 East Gaines Street
Tallahassee, FL 32301
Telephone: (904) 488-7464

Attorneys for the Florida
Public Service Commission

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RELEVANT DOCKET ENTRIES

FCC Docket Entries

In re Amendment of Part 31, Uniform System of Accounts for Class A and Class B Telephone Companies.

Date	FILINGS-PROCEEDINGS
1979	
Aug 10	NOTICE OF PROPOSED RULEMAKING adopted directing that interested persons may file comments on or before 10-9-79 and reply comments 11-12-79; and an original and 5 copies of all statements or briefs shall be furnished to the Comm. (FCC 79-263).
1980	
Nov 6	FIRST R&O adopted directing that Part 31, is amended as set forth in the Appendix attached thereto, to be effective Oct 1 81, provided, however, any company desiring to, may make such accounting changes retroactive to an earlier date in calendar year 1981; & the Sec'y. shall cause a copy of this R&O to be published in the Federal Register. (Chairman Ferris not participating; Commr. Lee dissenting & issuing a statement; Commr. Fogarty issuing a separate statement). (FCC 81-104). Released: Mar 31 81. 5-18-81—ERRATA released.
1981	
Apr 30	Petn. for Clarification of the Comm.'s Nov 6 80 First R&O filed for Nat'l. Assn. of Regulatory Utility Commrs.
Apr 30	Petn. for Recons. of the Comm.'s Nov 6 80 First R&O filed for the People of the State of California & the Public Utilities Comm. of the State of California.
Jun 11	Opposn. to the Apr 30 81 Petn. for Recons. & Petn. for Clarification filed for AT&T.
Jun 11	Opposn. to the Apr 30 81 Petn. for Recons. & Petn. for Clarification filed for GTE Service Corp.

Date	FILINGS-PROCEEDINGS
1982	
Apr 1	MO&O adopted GRANTING to the extent reflected therein Nat'l. Assn. of Regulatory Utility Commrs.' Apr 30 81 petn. for clarification; DISMISSING AS MOOT People of the State of California's Apr 30 81 petn. for recons.; the Sec'y. of the FCC shall cause this MO&O to be published in the Federal Register & in the Federal Communications Reports; & the Sec'y. shall cause to be served on each party of record in this proc. & each state comm. having jurisdiction over intrastate communication service a copy of this MO&O. (Commrs. Fogarty & Jones dissenting & issuing a joint statement) (FCC 82-155). Released: Apr 27 82. Apr 30 82—ERRATUM released to include Commr. Rivera dissenting after the phrase "By the Comm.". (3803).
Jun 7	Petn. for Recons. of the Comm.'s Apr 1 82. Dec 22 82 GRANTED (MO&O) MO&O filed for AT&T.
Jun 7	Petn. for Declaratory Ruling for General Telephone.
Jun 8	Joint Petn. for Clarification of the Comm.'s Apr 1 82 MO&O filed for GTE Service Corp., Continental Telecom, Inc. & United Telephone System, Inc.
Jul 2	Petn. for Review of the Comm.'s Apr 1 82 MO&O filed in the U.S. Court of Appeals for the District of Columbia Circuit by Richard McKenna & James R. Hobson, Attys. for GTE Service Corp. (Case No. 82-1747).
Jul 6	Petn. for Review of the Comm.'s Nov 6 80 First R&O & Apr 1 82 MO&O filed in the U.S. Court of Appeals for the District of Columbia Circuit by Raymond Scully, Lester G. Stiel, Michael Boudin & Leonard R. Stein, Attys. for AT&T. (Case No. 82-1752).
Jul 13	Opposn. to General Telephone's Petn. for Declaratory Ruling & Motn. to Dismiss the same filed for Office of Consumer's Counsel, State of Ohio.
Jul 14	Opposn. to AT&T's Jun 7 82 petn. for recons. filed for Nat'l. Assn. of Regulatory Utility Commrs.

Date	FILINGS-PROCEEDINGS
Jul 14	Response to AT&T's Jun 7 82 petn. for recons. filed for People of the State of California & the Public Utilities Comm. of the State of California.
Dec 22	MO&O adopted GRANTING AT&T's Jun 7 82 petn. for recons.; GRANTING General Telephone Co. of Ohio's Jun 7 82 petn. for declaratory ruling (petn. was filed with the Bureau) to the extent reflected therein; the Sec'y. shall cause this order to be published in the Federal Register; & the Sec'y. shall cause a copy of this order to be served on each state commission. (Commr. Fogarty issuing a separate statement). (FCC 82-581). Released: Jan 6 83.
Feb 11	Petn. to Review the Comm.'s Dec 22 82 MO&O filed in the U.S. Court of Appeals for the 4th Circuit by Donald G. Owens, Deputy Gen. Counsel, Russell W. Cunningham, Associate Gen. Counsel & Sherry H. Bridewell, Atty. for Virginia State Corp. Commission. (Case No. 83-1136).

UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

No. 83-1136

Virginia State Corp. Comm'r v. FCC

Date	FILINGS-PROCEEDINGS
1984	
Jun 18	ORDER upholding FCC Order, In re Amendment of Part 31, Uniform System of Accounts for Class A and Class B Telephone Cos., 92 F.C.C. 2d 864 (1983).
Oct 3	ORDER denying the petitions for rehearing and suggestions for rehearing in banc.

FCC 80-650

BEFORE THE

FEDERAL COMMUNICATIONS COMMISSION

WASHINGTON, D. C. 20554

Docket No. 20188

In the Matter of

Amendment of Part 31 (Uniform System of Accounts for Class A and Class B Telephone Companies) so as to permit depreciable property to be placed in groups comprised of units with expected equal life for depreciation under the straight-line method.

REPORT AND ORDER

(Adopted: November 6, 1980; Released: December 5, 1980)

BY THE COMMISSION:

I. Introduction

1. The American Telephone and Telegraph Company and the associated Bell System operating telephone companies (hereinafter AT&T or Bell) filed a petition on September 23, 1973 requesting that the Commission amend Part 31 of its Rules and Regulations (Uniform System of Accounts for Class A and Class B Telephone Companies) to permit property to be placed in subgroups comprised of units expected to have the same life for depreciation accrual rate development purposes. In essecnce, AT&T requested that the Commission amend Part 31 to allow the use of the straight-line equal life group (SLELG) procedure of depreciation rate development for property (except station connections) placed in service after December 31, 1974. The equal life group procedure is also known as the unit summation procedure. Currently, telephone companies are allowed to use only the straight-line group procedure of depreciation rate development as defined in Part 31 with the practice having been to determine depreciation rates by using the straight-line vintage group (SLVG) procedure.

2. The basic reason given by AT&T for proposing SLELG is that such a method would provide for the recovery of capital more nearly in line with its consumption as measured by the physical retirement of property. Under the SLVG method, depreciation is accrued on a class or subclass of depreciable plant on the basis of the average service life of each vintage group. According to AT&T, a reserve deficiency results at the time of retirement in the case of plant retired before an age equal to the average service life of the vintage group. This reserve deficiency is later made up by accruals on units that live beyond the average service life of the group. Under the SLELG method, depreciation is accrued upon those units of property in a vintage group that are expected to have the same service life so that, if projections are accurate, no reserve deficiency results since each unit is fully depreciated in the accounts at the time of retirement. The use of the SLELG method results in a higher accrual rate during the earlier years of the total property service life and a lower rate in later years.

3. In its petition, AT&T stressed the importance of the proposed change on the maintenance of the financial integrity of the Bell System companies. It alleged that, because the SLVG method now being used fails to match the capital recovery with the rate of capital consumption, the companies are failing to generate funds as rapidly as they should. Thus, AT&T asserted, the companies are faced with going to the outside capital markets for replacement of plant retired at an earlier date than the average service life when such funds should be internally generated through appropriate depreciation procedures. Bell claims that the proposed SLELG method will more closely match capital recovery with capital consumption and thus will provide an amount of internal cash flow which will more nearly match replacement construction requirements. AT&T proposed that the changeover from SLVG to SLELG be phased in over a five-year period to minimize the impact on depreciation rates, accruals, and revenue requirements.

4. In addition to AT&T's proposal to permit a change from the SLVG method to the SLELG method of depreciation, the Commission also is considering issues relating to the impact of

the proposal on all parties concerned and on the most effective way to implement the proposal.

II. History of the Proceeding

5. Following the receipt of AT&T's petition for rulemaking, the Commission, on October 10, 1973, issued a public notice asking for comments within thirty days on AT&T's proposal. Nineteen parties[1] filed initial comments, some of which were not timely and some of which were not served on AT&T. While some of these comments touched on the merits of AT&T's proposal, the bulk were concerned with procedural matters, such as, that time should be allowed to study the proposal or that hearings should be held on the subject. AT&T filed reply comments urging that the Commission proceed with the issuance of a Notice of Proposed Rulemaking (NPRM) at the earliest opportunity.

6. The Commission released a NPRM on September 19, 1974, establishing Docket No. 20188 and inviting comments and reply comments from all interested parties on AT&T's petition. After granting several requests for extensions of time, the Commission set March 24, 1975, as the date for filing comments and May 26, 1975, as the date for filing reply comments. In addition to the Bell System, eighteen parties filed comments in response to the Commission's notice and five parties filed reply comments. These parties are identified and their comments discussed Section VII, below.

7. In June 1976, the Commission awarded a contract to Ernst & Ernst, Inc., (Ernst), an independent accounting firm, to conduct a study of various aspects of depreciation. Ernst completed the study, entitled "Study of Depreciation Rate Practices and Policies," in July, 1977. Among the issues studied by Ernst were

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[1] The parties, including those whose comments were not timely and/or were not served on AT&T are GTE Service Corporation, Rochester Telephone Corporation, Arthur Andersen & Co., Arthur Young & Company, Coopers & Lybrand, Department of Defense, and the following state public service commissions: Alabama, Arizona, California, Illinois, Kentucky, Maryland, Michigan, Mississippi, New York, North Carolina, Ohio, Tennessee and Wisconsin.

the use of Equal Life Group Depreciation in general and the Docket No. 20188 proposal in particular. Following the completion of the study, the Commission issued a public notice seeking comments on the Ernst report. Thirteen parties, including the petitioner, filed comments, which are discussed in Section VII, below.

8. On March 22, 1978, GTE Service Corporation submitted a request to the Secretary of the Commission, together with a copy of the January 13, 1978, Canadian Radio-television and Telecommunications Commission's (CRTC) Decision in Phase I of the Inquiry into Telecommunications Carriers' Costing and Accounting Procedures (Cost Inquiry), which was initiated in 1972 by the Canadian Transport Commission. As the CRTC proceeding had been extensively covered in the Ernst report, GTE asked that the decision in that proceeding be included in the record of Docket 20188. That particular decision dealt specifically with the appropriateness of the ELG procedure and how it should be implemented by Canadian companies.

9. On February 25, 1980, the Chief, Accounting and Audits Division of the Common Carrier Bureau requested that AT&T and GTE provide revenue requirement impact studies for their respective domestic telephone systems based upon alternative accounting assumptions. The studies were received and served on all parties of record in this proceeding during March 1980. The Common Carrier Bureau announced in a Public Notice on March 31, 1980, the receipt of the revenue requirement impact studies and that any party(ies) wishing to comment on the impact studies could do so by May 1, 1980. Three responses were received on these revenue requirement impact studies, from the State of Wisconsin Public Service Commission, the New York Public Service Commission, and the Department of Defense on behalf of all Federal Executive Agencies.

III. The Role and Purpose of Depreciation Accounting

10. In order to understand the purpose of depreciation accounting, we should first know the purpose of accounting in general and some of its basic tenets. Accounting, as developed

over the years, has had as its most basic purpose the goal of presenting a financial picture to investors and others that would portray the current condition of the venture; the results of management's stewardship of the investors' funds; the relative integrity of the enterprise; and, on an interim or periodic basis, the results of operations or progress of the business. One of the earliest concepts was that of matching costs and revenues. That concept attempts to relate costs to the period in which they occur and against the revenues generated for which those costs were incurred. It has been said that every expense is related directly or indirectly to the production of revenue. However, not every expenditure is appropriately charged to the accounting period in which it is incurred. Expenditures for some items are more properly charged to the various periods in which they are useful in the production of revenues. Expenditures for long-lived assets are of this nature and the matching principle requires a determination of how much of the cost should be charged to each succeeding period. This process has been called "depreciation accounting."

11. Frequently, there is substantial misunderstanding as to the degree of precision embodied in financial statements and reports. The National Association of Railroad and Utilities Commissioners (NARUC) in the 1943 "Report of Committee on Depreciation" (p, 33) said:

> Only after a plant asset has lived its useful life will the true depreciation cost be known. The same difficulty is encountered in computing the annual profit and loss of businesses. Only after a business has been wound up can the absolute profit and loss be determined, and then only for the entire period of its existence. Nevertheless it is necessary to make determinations of depreciation and profit and loss periodically, at least annually, and the fact that very precise answers cannot be obtained should be no deterrent. Reasonably accurate results in both cases are all that should be expected and these can usually be achieved.

12. Even earlier than 1943, a similar observation directly related to the measure of depreciation was made by Justice Brandeis in *United Railways & Electric Co. v. West,* 280 U.S. 234,

262, 50 S.Ct. 123, 74 L.Ed. 390, (1930), who acknowledged the lack of precision in the exercise when he said:

> . . . an annual depreciation charge is not a measure of the actual consumption of plant during the year. No such measure has yet been invented. There is no regularity in the development of depreciation. It does not proceed in accordance with any mathematical law. There is nothing in business experience, or in the training of experts, which enables men to say to what extent service life will be impaired by the operations of a single year, or of a series of years less than the service life . . . even where it is known that there has been some lessening of service life within the year, it is never possible to determine with accuracy what percentage of the unit's service life has, in fact, been so consumed. Nor is it essential to the aim of the charge that this fact should be known. The main purpose of the charge is that irrespective of the rate of depreciation there shall be produced, through annual contributions, by the end of the service life of the depreciable plant, an amount equal to the total net expense of its retirement.
>
> . . . It is a bookkeeping device introduced in the exercise of practical judgment to serve three purposes. It preserves the integrity of the investment. . . . It serves to distribute equitably throughout the several years of service life the only expense of plant retirement which is capable of reasonable ascertainment—the known cost less the estimated salvage value. And it enables those interested, through applying that plan of distribution to ascertain, as nearly as is possible, the actual financial results of the year's operation.

13. Recognition of the inability of individuals to achieve absolute precision in arriving at various accounting measures however, should not diminish the striving for such measures since a failure to attain reasonable measures can result in erroneous and misleading financial reports. Reliance on such erroneous information, in turn, can result in erroneous investment and regulatory decisions.

14. All accounting measures are important, but in the case of capital intensive industries the measure of depreciation becomes

even more important. On the whole such industries are frequently regulated and annual revenue requirements reflect both the current measure of the consumption of capital (depreciation) and a provision for the costs (return requirement) of the capital still unrecovered through depreciation charges. If depreciation policies or practices were to be determined solely with concern for the level of revenue requirements, the actual measure of depreciation might be misstated. Such distortion of the measure of depreciation would in turn lead to a misstatement of the results of operations for the period and would also misstate the relative position of the enterprise as shown by its balance sheet. If such distortions were perceived by present and potential investors and were deemed to be deleterious to the safety and recovery of their investment, they in turn would likely demand a higher return on their funds. Consequently, a failure to properly measure by understating these costs would, in the long run, probably be offset by higher costs of capital without any real avoidance of the ultimate need to provide full recovery for the capital. The importance of a proper measure of depreciation and the potential adverse effects of improper measures on investors were addressed in the NARUC "Reports of Committee on Depreciation for the Years 1943 and 1944," starting at page 128:

> Those consequences stem from the fact that depreciation expense is an operating cost commensurate with the consumption of service life of the utility plant. Accordingly, if the annual accrual for depreciation is understated, there is a corresponding overstatement or inflation of net income and earned surplus. Investors are given an illusory and false impression with regard to earnings coverage, the effects of which are twofold and cumulative.... Moreover, if past deficiencies in depreciation accruals were substantial, it may be necessary to make up the back accruals by an appropriate adjustment of existing or future earned surplus and, in extreme cases, of the capital account itself.

15. Measures of costs under depreciation accounting, as well as other forms of accounting, are of the utmost importance and should be as accurate as circumstances will allow. The accounting measures of costs and revenues are the information base upon

which pricing and ratemaking decisions are predicated. These same measures establish the amount of expenses that a regulated enterprise must have an opportunity to recover[.] Finally, it is the provision for depreciation that ultimately determines how much remains in the rate base and thus, how much in dollars must be provided to investors as a return on their remaining investment.

IV. Statutory Provisions

16. Recognizing the need for accurate accounting measures and records, including an accurate measure of annual depreciation charges within reasonable limits, the Communications Act of 1934 gave the Commission the authority to "... in its discretion, prescribe the forms of any and all accounts, records, and memoranda to be kept by carriers subject to this Act..," These provisions are set forth in Section 220(a).

17. In Section 220(b), the Commission is required to "... as soon as practicable, prescribe for such carriers the classes of property for which depreciation charges may be properly included under operating expenses, and the percentages of depreciation which shall be charged with respect to each of such classes of property.... The Commission may, when it deems necessary, modify the classes and percentages so prescribed."

18. Paragraph (g) of Section 220 requires the Commission to give carriers "at least six months" notice before required accounting changes are to take effect.

19. Paragraph (i) of Section 220 requires the Commission to give state commissions having an interest a reasonable opportunity to present their views as to proposed changes in prescribed requirements.

V. Rules Implementing Section 220

20. The Commission's rules establishing overall accounting and the more specific depreciation accounting requirements are embodied in Parts 31, 33, 34, 35, and to some extent in Part 43. Parts 31 and 33 establish Uniform Systems of Accounts for Class A, B, and C Telephone Companies. Parts 34 and 35 establish

Uniform Systems of Accounts for Radiotelegraph Carriers and for Wire-Telegraph and Ocean-Cable Carriers, respectively. Part 43 establishes requirements for various reports of communication common carriers and certain affiliates. Part 43 derives its authority from Sections 211 and 219 of the Communications Act of 1934. It is of importance here that Section 43.43 sets forth requirements for reports of proposed changes in depreciation rates.

21. The essential provisions of Part 31 are of the most importance at this time as they cover all of the subject telephone companies for whom we presently prescribed depreciation rates. The only other carriers for which the Commission has recently prescribed depreciation rates are Western Union Telegraph Co. (WU), which is subject to Part 35 of the Commission's rules, and ITT World Communications, Inc., which is subject to Part 34 of the Commission's rules.

22. The portions of Part 31 that are of the most immediate significance in terms of defining or estalishing depreciation accounting requirements are: Section 31.01-3, Definitions; Section 31.02-80, Computation of depreciation rates; Section 31.02-81, Depreciation charges; Section 31.02-82, Classes of depreciable telephone plant; and Section 31.02-83, Plant retired for causes not factors in depreciation. Other sections of Part 31 set forth requirements and definitions of specific accounts such as the balance sheet accounts for telephone plant in service; extraordinary maintenance and retirements; and depreciation reserve. In the operating expense accounts, similar provisions are made for the depreciation and the extraordinary retirements expense accounts.

23. Under the definitions portions of Parts 31, 34 and 35 the significant differences are as follows:

Part 31 includes a definition of group plan—which does not appear in Parts 34 and 35.

> Sec. 31.01-3 Definitions.
>
> (q) "Group plan," as applied to depreciation accounting, means the plan under which depreciation charges are accrued upon the basis of the original cost of all property included in each depreciable plant account, using the average service life thereof properly weighted, and upon the retirement of any depreciable property its full service value is charged to the depreciation reserve whether or not the particular item has attained the average service life.

Parts 34 and 35 include defintions of "Net book cost" and "Subclass" which do not appear in Part 31.

> Sec. 34.02-1 Restrictive use of certain terms. "Net book cost," as applied to a specific portion of plant, means the "book cost" of that portion minus that part of the related depreciation (or amortization) allowance account that is assignable to that portion of the plant.
>
> "Subclass,"as applied to depreciable plant, means that portion of a "class" of plant, preferably corresponding to one or more "subprimary" plant accounts, to the cost of which a specific percentage rate of depreciation is applied in accounting for "depreciation," which percentage rate differs from those that are applied with respect to other "subclasses" of the same "class" of such plant.

24. Rules regarding treatment of retirements of plant for causes that were not factors in the computation of depreciation (extraordinary retirements) are essentially identical for Parts 31, 34 and 35.

25. The rules for the computation of depreciation rates are essentially identical except that Part 31 includes a sentence as follows:

> These percentage rates shall be computed in conformity with the group plan of accounting for depreciation. . . .

26. Part 31 also includes some specific reference to removal costs of station apparatus and its accounting in the station connections account. This portion is unique to the telephone companies and would not be applicable to the other types of carriers.

27. Parts 34 and 35 under the instructions for the computation of depreciation rates, as previously stated, are essentially

identical to Part 31, with the exceptions noted above, and in addition have one other very significant difference. Both Parts 34 and 35 include language specifically addressing the calculation of and use of "remaining-life rates." The language in Section 34.04-2, Computation of depreciation rates, says:

> (c) . . . However, a carrier, upon receiving prior approval from the Commission or, upon prescription by the Commission, shall apply such depreciation rate as will amortize the difference between the net book cost of a class or subclass of plant and its estimated net-salvage value during the known or estimated remaining service life of that plant. Any carrier which, at the effective date of this rule, is applying the remaining-life method of depreciation accounting may continue to do so unless otherwise directed by the Commission.

28. This last item regarding remaining-life depreciation will be addressed further in a discussion of reconciliation of differences in the Commission's rules. Paragraph 12 of the NPRM addressed the question of whether conformity, by like amendments, should be sought in the Commission's rules.

29. A common thread throughout the Commission's rules for depreciation accounting has been that its purpose is to allocate through annual charges to expense the service value of the property over its service life in accordance with the straight-line concept. The Commission defines "service value" as the difference between original cost and net-salvage value, and "service life" as the period of time between installation and retirement of plant. The Commission's definition of the straight-line concept as stated in Part 31, Section 31.01-3, Definition is:

> (gg) "Straight-line method," as applied to depreciation accounting, means the plan under which the service value of property is charged to operating expenses and to clearing accounts and credited to the depreciation reserve through equal annual charges as nearly as may be during its service life,

30. The Commission's requirement that depreciation charges follow the straight-line concept is one that is well recognized by other regulatory bodies and more importantly enjoys widespread

use and recognition by businesses in general. The comments of the Committee on Depreciation of NARUC in its 1943 report (page 89) are of interest:

> Widespread Use of Straight-line Method
>
> It is significant that the straight-line method is in almost universal use. This does not prove it to be the best method. Nevertheless, when business managements throughout the country, free to adopt any reasonable method, have used the straight-line method, such general acceptance of the method is entitled to great weight in considering its merits.

31. In 1975 the Technical Research Division of the American Institute of Certified Public Accountants found that the straight-line pattern for allocating depreciation charges was still the overwhelming choice among businesses in general.

VI. The Investors' and the Consumers' Interest in the Cost and Recovery of Capital

32. In considering this matter it is important to recognize some fundamental concepts that have been recognized by both the courts and practical observers in business, finance and academia.

33. As observed by the U.S. District Court in *Goelet v. United States*, 161 F.Supp. 305 (S.D.N.Y. 1958), the purpose of depreciation is to make provision for recovery or charge of the original cost of the property by the end of its life. It is noteworthy that the court did not say more, nor did it say less. The comments of Justice Brandeis in *United Railways & Electric Co. v. West, supra,* also considered the purpose of the charge.

34. Forty-three years later in the course of its review of another case involving depreciation recovery, the United States Court of Appeals, District of Columbia Circuit, enunciated the same principle of investor recovery of the whole cost of investment and the attendant interim inaccuracies of the process in *Democratic Central Committee of the District of Columbia et al., Petitioners v. Washington Metropolitan Area Transit Commission, Respondent,* 485 F. 2d 786 (1973) where it said:

Computations of the cost of ordinary depreciation—normal physical deterioration—are made on the basis of estimates of service life and salvage value, and charges therefor are usually spread over the service period. Depletion allowances are similarly based on estimates of productive life, and usually are similarly spread. Even obsolescence may sometimes be foreseen and calculated in much the same manner. It is evident that if all predictions are accurate and the asset remains in service for precisely the period anticipated, the process will eventually yield to investors the exact amount of their investment, and will ultimately cost consumers the same amount. Consumers will thus absorb the investment loss and investors will be made whole.

But calculations, even of the highest predictive quality, sometimes go awry. Service life, productive life or salvage value may turn out to be more or less than originally estimated. Obsolescence may be slower or faster than expected in the beginning, or may arrive suddenly, and damage to or destruction of the asset may occur just as suddenly. In most instances, however, the consumers' financial obligation remains intact, the investors' right to recoupment remains unimpaired, and appropriate adjustments must be made. This is so although in terms of original expectations, the loss of serviceability is premature. Consumers bear the risk of that loss unless investors have been compensated for assuming it; if, as is more usual, investors have not, return of their investment is fully assured.

In this milieu, the distribution of the risks and burdens on utility assets is apparent. Consumers must ordinarily bear the expense of normal maintenance and, according to some decisions, of deferred maintenance as well. Beyond that, consumers must usually absorb the investment losses wrought by normal wear and tear on depreciable assets, and by exhaustion of depletable assets. *Even when an asset is underdepreciated at the time it is retired from service, consumers must reimburse the investors therefor. And when utility property becomes unsuitable by reason of obsolescence before investors have fully recouped their investment in it, the loss is passed on the consumers.* (Emphasis added; footnotes omitted)

35. Those same principles were acknowledged by this Commission in its Phase II Final Decision and Order in Docket 19129 at paragraph 172 where it cited the above court decision and said:

> We believe that these principles apply with equal force to capital gains on the disposition of AT&T's retired plant (which was once in the rate base) and that, under these principles, the gains in question here should benefit the ratepayer. By the same token, the ratepayers bear the risk of loss from sale below current book value of the property.

36. In the next paragraph of that order the Commission went on to say:

> We turn first to the case of depreciable property where we believe the fact that the users bear the risk of loss may be most clearly seen. *It is settled law that AT&T's stockholders are entitled to the opportunity to earn a fair return on the amount of capital they have prudently invested in the regulated enterprise.* See *F.P.C. v. Hope Natural Gas Co., supra*, at 603, *Missouri ex rel. Southwestern Bell Telephone Co. v. Public Service Commission*, 262 U.S. 276, 289-90 (concurring opinion of Brandeis, J.) (1923). In practice, this translates to a return on the original (or depreciated book) value of AT&T's assets used and useful in providing telecommunications service. *Depreciation, in turn, is calculated on the original cost of AT&T's plant and is designed to regain over the service life of the asset the entire amount the investors paid to purchase it.* The money necessary to repay the investors, of course, comes from the users of AT&T services. Thus the ratepayers bear the risk both in terms of the return they pay the investors for the use of their capital and in the reimbursement of the investors for the decline in value (depreciation) of the assets used to provide service. To make this clear, we note that AT&T's method of depreciation, the Straight-Line Vintage Group method, see *supra* n. 90, does not recognize gains or losses. Under group depreciation, individual items of plant are grouped with similar types of

plant and the depreciation is calculated on the projected average life of the group. If an item within a group is destroyed, becomes technically obsolete, or otherwise is rendered unfit for service ahead of the projected date and is thus prematurely removed from service, the ratepayer reimburses AT&T for the loss of that asset because AT&T merely reduces the asset account and the depreciation reserve by equivalent amounts. Depreciation, and return, are then calculated from year to year as if they were still in the rate base until the investors have recovered the full purchase price plus return on their investment. This method of depreciation is prescribed for AT&T's use and is fully in accord with regulatory theory. It has the benefit, in an ongoing enterprise such as AT&T, of spreading losses over a reasonable period so as to minimize the impact on the ratepayers of catastrophic losses in any one year (if they are not covered by insurance). Still, this does not change the fact that the ratepayers bear the risk of loss in value. Thus, when such a piece of property is retired and disposed of and a gain results, the equities of the situation would suggest that the ratepayer should receive the benefit of that gain. Further, it is reasonable that the gain should be measured from the current book value of the property, original cost less depreciation and that it should be reflected as operating revenue. (Emphasis added)

VII. Evaluation of the ELG Proposal
A. Positions of the Parties

37. The parties filing comments in this proceeding, in addition to the Bell System, generally can be grouped into three categories—the independent telephone industry, along with Western Union Telegraph Co. (WU); the accounting profession; and the state regulatory commissions and associations representing these commissions. The basic positions of these groups, and the positions of the various individual parties making up the groups, are discussed below.

38. The Bell System, obviously, urges the Commission to adopt the ELG method of depreciation. In its comments, AT&T

repeats its earlier position put forth in its petition, and discussed in the "Introduction" to this order. Essentially, Bell stresses the importance of matching capital recovery with capital consumption, which will provide more internally generated funds to meet replacement construction requirements. Also, AT&T underlines the importance of the proposed change in depreciation practices on the maintenance of the financial integrity of the Bell System companies.

39. The independent telephone industry (comments were filed by General Telephone and Electronics, United Telephone Co., Continental Telephone Co., and the United States Independent Telephone Association) and WU favor the adoption of the ELG method of depreciation, but with certain qualifications. For example, while General Telephone and Electronics (GTE) supports the use of ELG, it recommends applying the method to all new property at one time, rather than using a gradual "phase-in" approach as desired by AT&T. In addition, GTE suggests the use of "capital recovery schedules" which would set an advance determination of capital use and recovery, and then have the company accountable for the achievement of the schedule. The United Telephone Company (United) favors the use of ELG, and recommends that all telephone companies simultaneously phase-in property under that method. United also recommends that companies be allowed to use simulated data in using ELG because of the complexities involved in some cases in the use of actual data. Continental Telephone Company (Continental) also favors the use of ELG, but is concerned about the difficulty of attempting to follow AT&T's complex methodology. Therefore, Continental requests that the methodology used by AT&T not be made mandatory. The United States Independent Telephone Association (USITA) favors the adoption of ELG, but states that its use should be elective and should be as flexible as possible. WU does not object to the adoption of ELG, but does not want to use it.

40. Two accounting firms and the American Institute of Certified Public Accountants (AICPA) filed comments in response to the NPRM in this proceeding. The firm of Coopers & Lybrand endorsed the use of ELG, but commented that the use of

that method depended to a great degree on the availability of data. While the Bell System would have the necessary data to use ELG, Coopers & Lybrand believes, it is questionable whether small firms would have that data. The firm of Arthur Andersen and Company recommended that the Commission adopt the use of ELG, and encouraged other commissions to follow the FCC. Finally, the AICPA endorsed the use of ELG, given the availability of adequate data, as it should result in a more accurate matching of capital recovery with capital consumption which seems to be implicit in the Commission's rules.

41. Seven state regulatory commissions (California PUC, Colorado PUC, Florida PSC, Kentucky PSC, Maryland PSC, New York PSC, and Wisconsin PSC), plus the NARUC Subcommittee of Staff Experts on Accounting, the Southeastern Association of Regulatory Utility Commissioners (SEARUC), and the Department of Defense filed comments in response to the NPRM. All of these parties opposed the adoption of ELG, for a variety of reasons. The principal reason given by the state commissions for opposing ELG was that its adoption would result in an increase in revenue requirements and consequently an increase in rates to subscribers at the same time that inflation was driving up the prices of other utilities such as electric and gas. Additionally, they argued that the adoption of ELG would result in an added burden, and thus an added cost, to the commissions attempting to administer the method (most of the state commissions commenting believed that the method would be too complex to cope with and that commissions would be unable to administer it); it would result in an added cost to companies utilizing the method; and it would result, effectively, in a domino effect leading to the approval of the use of ELG by other regulated utilities. The NARUC subcommittee expressed its concern about the burden of increased revenue requirements on the ratepayer, and added that if ELG is adopted by the FCC, its use should be made mandatory only for the large telephone companies and elective for others. The SEARUC and the Department of Defense both opposed the adoption of ELG at the time their comments were filed, and recommended that hearings be held on the matter. Other arguments contended that the use of ELG would lead to higher income taxes, thus a greater burden on

ratepayers; that ELG was not a proper group method within the definitions of the Commission, and that there was no demonstrated need for increased cash flows for the industry.

42. Reply comments were submitted by six parties in this proceeding—AT&T, GTE, the Wisconsin PSC, the California PUC, the New York PSC, and the Department of Defense. Essentially, these replies reiterated the positions of these parties expressed in their earlier comments. AT&T argued that while the immediate impact of the adoption of ELG is an increase in revenue requirements, and thus rates, a cross over point will be reached in the longer-run and rates will actually decline. Additionally, AT&T notes that although the method may be complex to administer, with the use of computers by commissions, much of the complexity would be eliminated. Bell also stresses, as it had in earlier comments, the importance of matching capital recovery and capital consumption. GTE emphasizes in its reply comments the superiority of ELG over VG because the recovery of capital coincides more closely with consumption of capital. The state commissions and the Department of Defense contend in their replies that ELG does not provide a better matching of capital consumption with capital recovery and that the adoption of ELG is, in essence, the granting of a rate increase. However, the NARUC Subcommittee of Staff Experts on Accounting did recognize that there was technical support for ELG.

43. The Ernst report, "Study of Depreciation Rate Practices and Policies," was completed in July, 1977. As mentioned earlier, the use of ELG depreciation in general, and Docket No. 20188 in particular, were among the issues considered in the study. Ernst concluded that ELG provided a better matching of capital consumption with capital recovery than VG. Moreover, the study found that the use of ELG would increase a company's internally generated funds compared to the VG method and that the use of ELG would provide more information to commissions about capital management by utilities. However, Ernst also pointed out that the use of ELG would result in increased revenue requirements initially, and possibly over the longer term, depending on growth rates, cost of capital and tax policies. Additionally, Ernst acknowledged that the use of ELG would result in an increased

regulatory burden and consequently, increased regulatory staffs. In its conclusions Ernst recommended that the Commission should adopt ELG on a flash-cut basis as all of the Commission's objectives would be better served by ELG than VG; that it be allowed in such a manner that it could be adopted by any company, large or small; that depreciation reserves be established by depreciable category and maintained on a continual basis; that the FCC explore possible refinements in depreciation practices; that implementation problems, such as salvage accounting and application of ELG by the Independents be resolved by the regulators and the carriers; and that the Commission should monitor the activity in the accounting community regarding other concepts of "cost" and depreciation. The last recommendation was directed toward inflation type measures of accounting data.

44. Ten parties commented on the Ernst report. These were AT&T, GTE, United Telephone Co., USITA, California PUC, Florida PSC, New York PSC, Wisconsin PSC, the NARUC subcommittee and the Department of Defense. Essentially, all of these parties repeated their earlier positions on Docket No. 20188. AT&T's lengthy comments were the only comments to address the study in depth, and those comments pertaining to Docket No. 20188 were much the same as the earlier comments and reply comments filed in the proceeding.

45. In March of 1978, GTE submitted a copy of a decision by the CRTC in Phase I of the Cost Inquiry, which GTE requested be placed in the record of this docket. The particular decision focused on the allowance of ELG as a depreciation method for telecommunications carriers, and did approve such use.

46. Finally, during 1980, upon request of the Chief, Accounting and Audits Division, Common Carrier Bureau, AT&T and GTE filed updated impact data with respect to the implementation of ELG with the Commission and upon all parties of record. Following these submissions comments were solicited by a public notice which was also directly served on all parties of record. Comments were filed by the New York and Wisconsin Public Service Commissions and by the Department of Defense. The commenting parties repeated their earlier comments.

B. Discussion of the Merits

47. We begin by acknowledging that the issues involved in this proceeding are complex and not readily characterized as "right" or "wrong." Where depreciation methods and procedures are concerned, reasonable judgment must often substitute for mathematical certainty. We also recognize that a Commission-endorsed depreciation policy must consider economic and other public policy points of view. As will be specified later, we are directing the staff to continue to analyze accounting and depreciation issues within this broader context.

48. With respect to the straight-line equal life group procedure, we find that its application on an optional basis will further the mandate of Section 1 of the Communications Act, "to make available, so far as possible, to all people of the United States a rapid, efficient, Nation-wide, and world-wide wire and radio communications service with adequate facilities at reasonable charges. . . ." 47 U.S.C. §151. The primary attraction from an accounting perspective of SLELG is that it appears to calibrate more closely the flow of revenues with the recovery of capital. Communications is a large and growing component of our nation's economy. It offers bright prospects for improving our society's productivity. Technological trends suggest an increasingly dynamic environment for telecommunications, with innovation in equipment and services proceeding at a much more rapid pace than in the past.

49. If the public is to realize the benefits of advances in communications, it is necessary that accounting and depreciation rules not stifle innovation and inhibit the introduction of new technology. It is important that the companies, their customers, and their investors, as well as the regulators, all have an accurate and objective financial picture of the companies' operations and capital requirements. The seeming attraction of stretching out lives to hold down depreciation expenses may impose longer-term costs on our society that far outweigh the short-term advantages. Although our decision to permit SLELG (or, with prior approval or appropriate showing, other methods or procedures), is likely to result in an increase in the near term in revenue requirements, we believe that the relative size of the increment will be repaid many

times over in future years as the ability of regulated telephone companies to continue to provide "... rapid, efficient ... communication service with adequate facilities at reasonable charges is enhanced." The ultimate burden on different user groups of any future rate increases resulting from our decision depends on the particulars of future plant investment as well as on the jurisdictional separations of such investment and corresponding expenses. The latter is the subject of a recently established Federal-State Joint Board.[2] Moreover, our decision to phase in the implementation of ELG will ameliorate any revenue requirement impact and permit us to take further action in a timely manner if warranted.

50. The remainder of this section will explain in greater detail the basis of our decision. To begin, we note an interesting view expressed at the turn of the century:

> The Question of Depreciation is one upon which so many articles have been written and so many opinions expressed that there would not appear to be much more which could profitably be said on the subject.[3]

Nevertheless, the record in this docket and the professional literature on the subject since that date are voluminous. From a thorough examination of the record and a comprehensive survey of the literature, we believe we can draw the following conclusions.

51. First, given the uncertainties of life estimation and results from statistical theory, variance of errors in prediction is likely to be less for larger groups of investment than for individual elements or smaller groups. Since accuracy is desirable, group methods are to be preferred according to this criterion. This should not preclude the application of unit methods for specific circumstances at some future time if the circumstances so warrant. Our rules should be changed to acknowledge such a possibility.

52. Second, as the amount to be depreciated consists of one known (original cost) and two unknowns (cost of removal and salvage), we think it better to insist on a more disaggregated measure of accumulated depreciation (depreciation reserve) for the original cost of property while permitting a more general aggregation of accumulated depreciation provisions for the cost of removal and salvage. Such provisions could be vintage level reserve records for original cost and category level reserves for removal and salvage. This is similar to the decision of the CRTC in the case of ELG decided January 13, 1978.

53. Third, as to the methods to be allowed, we can only take notice of the consistent and preponderant choice of straight-line allocation patterns used by both the majority of regulatory bodies and more importantly by the majority of businesses, especially those that are unfettered by regulation. This choice has been made repeatedly over the years. Its preferability is noted in the proceedings in Docket 14700 before the ICC from 1923 to 1926 and prior to that by its selection and application by AT&T, in the NARUC report in 1943, and again in the survey conducted by the AICPA Research Division in 1975. Given that consensus, this Commission reiterates its preference for the straight-line allocation method. However, as in all things predictive, circumstances in the future might warrant some other allocation method for specific categories of investment under specific circumstances. In the event that a carrier under the jurisdiction of this Commission should make a persuasive argument in support of application of some timing pattern other than straight-line, then the staff of this Commission will review the circumstances and make appropriate recommendation to the Commission as to whether depreciation rates calculated by a method to achieve an allocation of costs other than straight-line should be approved or denied. In short, our rules should be amended to indicate that straight-line is a preference only absent other persuasive proof.

54. Fourth, it is certain that we have entered the age of computers and that earlier objections to the unit summation or ELG methods, based on the added mathematical complexities,

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[2] *Notice of Proposed Rulemaking and Order Establishing a Joint Board*, FCC 80-339.

[3] *The Accountant*, August 8, 1903 as quoted in "Accounting for Depreciable Assets," Technical Research Division, American Institute of Certified Public Accountants, Inc., 1975, p. 1.

are no longer of themselves a justifiable basis for denying companies having such data processing capacities the use of any given method. The calculations, though voluminous are straight forward and readily programmable.[4]

55. Fifth, from the perspective of accounting, the unit summation or ELG procedure is a superior one. This opinion was expressed as early as 1932 by Robley Winfrey, a noted expert in depreciation methods and processes. His views are summarized in passages from the book referenced in footnote 4:

> The unit summation procedure when used with the straight-line depreciation method corresponds to the basic concept of straight-line depreciation as generally understood in relation to single units of property. The results, when this procedure is used, are systematic and consistent with respect to a unit, a vintage group, a plant account, and the total investment in a utility system. The unit summation procedure permits the accrual of depreciation on property while it is serving the customers and at the time such expenses are rationally allocable to those customers.
>
> The use of the unit summation procedure to apply the straight-line method results in a systematic and consistent method of depreciation, both from a year-to-year standpoint and from a unit, account and total plant standpoint. The manner in which the property is grouped should not affect the overall company accrual. The procedure provides a means for accruing the depreciable cost, no more or no less. It also results in an accrued amount directly related to the life of the existing property and in an amount consistent with good judgment when related to the age and life of a matured property.

Id, at pages 36, 38.

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[4] See Fitch, Wolf, and Bissinger, *The Estimation of Depreciation*, Center for Depreciation Studies, Western Michigan University, 1975, p. 38. Similar support was given by Robley Winfrey (co-author), *Engineering Valuation and Depreciation*, 1953, in a letter to Dr. Fitch which the authors reproduced at page 45 of their text.

56. Other parties expressed similar conclusions in the record (see e.g., Ernst report at p. 443, Comments of AICPA, dated March 24, 1975). However, comments filed by the Wisconsin, New York, California, and Maryland Commissions claim similar virtues for the currently used straight-line vintage group method. The principal contention of these commissions seems to be based on a definitional distinction and on a quote from a text by Winfrey. These arguments are sufficiently refuted by the Ernst report (at page 329) and by the statements of Winfrey (see paragraph 55).

57. Accordingly, this Commission accepts the recommendation of the staff based on analysis of the record and the literature that the unit summation or ELG method is acceptable, provided it is assured that adequate data is available for proper application of the method; that record keeping and reporting practices will enable monitoring of the reasonableness of the rate of allocation of both original cost and provisions for salvage and removal; that such allocation of original cost will achieve allocation over the service life of the property neither more nor less than 100% of the investment net of salvage value.

58. Sixth, comments have suggested that the unit summation or equal life group method does not enable or enhance determinations of salvage, removal, or life survivorship estimates. Of course it does not, for it is nothing more than an added step to the process that is presently being followed in the application of the vintage group method. It is, as its proponents state, nothing more than a mathematical process, going one step further than the present vintage group calculations. It has been precisely that further step and its requisite date handling requirements that has blocked prior usage of this method.

59. Seventh, argument has been made that the unit summation method or ELG is more sensitive than is the straight-line vintage group method to the shape of the estimated life curve which is applied to the particular property. This appears to mean that SLVG is more concerned with survivorship over the whole-life span than with the measurement of property survivorship within more limited interim periods. This may be true; however, it is the basic contention of the advocates of ELG that the primary

failure of the VG method is in relation to the allocation of costs for those properties which last only a few years in plant groupings that tend on average to live for a great number of years. It is to be presumed and expected that those studying the survivorship patterns, both company and commissions, will strive to select the most representative data, including its probabilities, for rate setting purposes. Again, this is not an exercise in precision, but it is a most reasonable attempt to measure, and re-measure as necessary, the consumption of capital of long lived investments.

60. Eighth, the petitioners have asserted that adoption of ELG will enhance cash flqws or internally generated funds, thus reducing the need for and demands upon outside capital resources. Those in opposition have contended that adoption will increase revenue requirements on consumers and will impose an added burden on regulatory commissions and smaller carriers. Further, opponents have contended that adoption might have a domino effect—forcing approval of similar methods for other utilities.

61. There is no doubt that any change which moves the recognition of costs from a decelerated or deferred mode to a more instant recognition will increase both revenue requirements and cash flow. The results are the same. Any resulting ratemaking changes can and should be addressed in the rate setting process.

62. The contention that the adoption will impose added burdens on regulatory bodies is not without merit. It is true that the final calculations, that is the added step, will require additional efforts. On the other hand, the contentions that more work will have to go in to the preliminary processes merely acknowledges that perhaps not enough attention was being given to the life, salvage and removal estimation processes because within broad averages, errors due to lack of attention went unnoticed. That is not of itself a sufficient basis for denying more precise measures of cost allocation.

63. The proposition that smaller carriers might either be disadvantaged or unable in any event to implement the unit summation process acknowledges something that has long been in existence. In fact, for many of the smaller carriers, the requisite

data necessary to support really fine applications of the vintage group process have been lacking. In its approval of the ELG method, the Commission does not intend to make it, or any other method, mandatory.

64. The question of appropriate depreciation methods for other utilities is an appropriate subject for those authorities having jurisdiction. In the instant order, this Commission addresses depreciation issues for carriers within its statutory authority and responsibility.

65. As stated heretofore, both the impact of revenue requirements and the burdens placed upon the regulatory staffs require consideration. Furthermore, the need for assurance that the reporting and record keeping practices provide adequate safeguards and checks on accountability becomes more critical as the industry continues to grow and change. Therefore, the Commission will direct that implementation be allowed on a progressive basis. During 1981, the staff will address the adoption of ELG by those carriers capable of implementing it and providing adequate supporting and controlling mechanisms and only for new additions to property falling within the broad classification of outside plant. The impact data provided by the carriers indicate that the added revenue requirements would approximate $80 million in 1981. During 1982, the staff and carriers can address adoption of ELG for new additions to property falling within the broad classification of central office equipment. The impact data indicate added revenue requirements for this category of plant would approximate $136 million if implemented in 1981. Delaying implementation by one year is likely to lead to a somewhat higher first year impact. Finally, in 1983 the staff and carriers can address implementation of ELG for all new plant additions to the remaining categories of plant investment. It should be noted that this could conceivably include the categories of station apparatus and large PBX as well as buildings and general equipment and station connections. The impact anticipated from adoption of ELG for buildings and general equipment are expected to be very minimal. The major anticipated impact is expected from station apparatus and large PBX. However, actions being taken in both Docket 20828, the Second Computer Inquiry, and Docket

79-105, Station Connections, are focused on the probable deregulation, or in any event expensing of, the new additions to such investment categories. Such actions are expected to become final in 1982 and therefore the likelihood of application of ELG methods to such property investments is extremely low. The Commission believes that the phasing in of the new methods in this manner will substantially reduce the immediate impacts on both revenue requirements and staff resources.

66. Ninth, the petitioners proposed among other things to have a true-up process approved for application to the errors that would gradually enter into the ELG, or into any other, process. Opponents have stated that the proposed annual true-up process would force state and federal staff experts to concern themselves with addressing changes to every vintage of every category of plant in every year. This appears to be true, and the only immediate solution would appear to be some form of blanket authority to be granted to the carriers. The Commission does not believe that such a blanket approval would be appropriate, nor does it believe that it would meet the requirements of Section 220 of the Act that all changed depreciation percentage rates be prescribed by the Commission. Errors are likely to occur in any method predicated upon estimates of prospective events. We will address corrective measures to be applied to embedded investment in Section X of this order. ELG adjustments will be handled by application of remaining-life adjustments in the setting of rates during the normal represcription process.

VIII. Alternative Methods

67. In the NPRM dated September 19, 1974, at Par. 9, we asked parties to submit alternative methods. Three alternative methods have been presented for consideration. They are as follows:

A. Declining Balance x 1.7

This method was considered by Ernst but lacked any substantial explanative support. The method was offered as a surrogate for achieving the result of ELG without having to

engage in all the extensive work and computations inherent in the ELG method.

Ernst rejected the method as a proper surrogate for ELG. One major drawback was that the factor of 1.7 was only appropriate for the illustrative data submitted by the petitioner in support of its application. The factor of 1.7 was not appropriate for either overall actual conditions or for any particular plant investment category of any real carrier. In short, the factor was a figure that was backed into after first having ascertained the ELG result by application of all of the complexities of calculation of the ELG method.

B. Remaining-Life Method

This method, as an alternative to ELG, was proposed by the California Public Service Commission, which presently employs remaining-life calculations of SLVG rates for intrastate ratemaking purposes in its regulation of the Pacific Telephone and Telegraph Company. It should first be noted that remaining-life is not, as such, a method; it is merely a further step in the calculation of depreciation rates and is a concept that is applicable to almost any method for calculating depreciation rates. The application of remaining-life will be addressed separately further on.

C. Capital Recovery Schedules

The use of capital recovery schedules was recommended by GTE as an alternative to both ELG and SLVG. Such schedules would be precalculated for various investment survivorship patterns and probable average life and total life span that are encountered in experience with telecommunications plant investments. Companies having more advanced capabilities, such as GTE and/or AT&T, could calculate the table of factors to be applied to investments fitting the various survivorship patterns. Smaller companies could then select from among the several choices and apply those factors to their investment. The schedules might not achieve the fine tuned results expected of the larger carriers but should for all intents and purposes achieve reasonable results.

68. In our discussion of the merits of arguments surrounding the adoption or use of the unit summation or ELG method, we reasserted our support of the straight-line allocation standard or pattern while leaving the door open to other allocation patterns if and when proven appropriate and necessary. (See para. 53, *supra.*) We also acknowledged our preference, over the years, for group methods as opposed to unit applications.[5]

69. Within those parameters, we recognize that not all carriers have the requisite data bases or sophisticated resources in terms of modern data processing equipment. Lack of either can be a serious impediment to implementation and application of complex methodologies. The Commission wishes to clarify its belief that the purpose of allocating costs of depreciable plant in a consistent, predictable and rational manner is to achieve as accurate a measure of consumed capital costs as is reasonable of attainment. It is this goal, rather than the particular method, that is of primary importance.

70. The burden of demonstrating that any particular method is both reasonable and practicable for the purposes of meeting the requirements of depreciation accounting is upon the carrier seeking approval of such method or application. The Commission cautions however that alternative or new methods must meet the tests of accountability and generally are more suited for application to prospective property additions, rather than application to presently embedded plant.

IX. Limiting Application of New Methods to New Plant Additions

71. Admittedly, any change in accounting practices entails more work effort. Given the complexity of accounting for telephone property, it seems reasonable to approach such changes on a gradual or phased-in basis.

72. Application of the ELG method requires maintenance of investment and reserve for depreciation data on a vintage level of

[5]As we noted in para. 51, supra, we are prepared to consider unit depreciation proposals in special circumstances.

investment basis. At the present time, AT&T does not have book reserve for depreciation balances at even the plant account or category of investment level, let alone at the more disaggregated vintage level. Under such conditions, it would appear to be impractical to attempt to change to ELG methods for presently embedded plant.

73. If new additions to plant are depreciated under the ELG or some other method, then the balance subject to SLVG depreciation will diminish and ultimately be fully depreciated and retired. In the end result, all methods approach a 100% recovery. Thus by stopping the continued replenishment of investment subject to the SLVG method, the reserve balance attributable to that investment will ultimately approach the same results that would have been attained if the ELG method had been followed.

74. Furthermore, the present embedded investments have other problems associated with them. Specifically, the lack of detailed, disaggregated reserve data impedes development of supporting cost of service data. The lack of reserve accounts by plant investment category or account impedes application of corrective action to overcome real deficiencies of cost allocation and capital recovery arising out of cumulative past errors of life estimation. Lack of detailed reserve information also impedes a ready assessment of the net book cost of investments in categories of plant proposed for deregulation under the provisions of Docket 20828, the Second Computer Inquiry.

75. Properly addressing these problems requires a determination of the appropriate portion of present book reserves to be allocated or identified as being applicable to specific plant investment categories. Continued treatment of present investment amounts on a consistent basis through continued use of the SLVG method is the most logical way to go. Introduction of new methods in mid-stream would only further complicate already difficult problems.

X. Remaining-Life

76. As discussed earlier, there is nothing in the training of experts nor are there any mathematical laws that will impart an

absolute precision to the determinations made under presently known depreciation practice. Consequently, there would appear to be some need for a corrective mechanism if one wishes to attain the goal of assigning or allocating costs over the service life of any particular asset. If actual results appear to be allocating costs faster than necessary to achieve 100% recovery by the likely retirement of a particular investment, then there is a need for a reduction in the current and prospective charges in order to assure that not more than 100% will be charged by the time of retirement. If on the other hand, it appears that retirement will occur before all the costs are allocated, then an equivalent mechanism is needed in order to increase current and prospective charges so that all costs are allocated by the time of retirement. If such circumstances are not self balancing then the likelihood exists that either too much or too little will be allowed to stand in the reserve, perhaps for perpetuity. Such a result is not desirable.

77. At the present time, and over the past decades, depreciation rates calculated by this Commission have been arrived at by a process or final step known as "whole-life." Meritoriously, this approach attempted to calculate the annual charge that would be appropriate, if the currently estimated whole-life of the asset had, in fact, been so determined at the onset of the asset's life. Thus, customers would only be charged costs equivalent to the pro rata portion of total cost applicable to the instant time period. Current customers would not be charged any costs attributable to past periods, nor would they be charged any costs attributable to future time periods.

78. The use of whole-life rate calculations did not create any problems as long as property could be grouped in one very large universe without concern for attributes of any particular type of property, and as long as the overall results achieved tended to approximate theoretical results. This latter condition would occur when various errors of estimate were fully or almost fully compensating. Such conditions appear to have been in existence up to and including the late 1960's. After that, the factors involved in determining lives and types of telecommunications investment began to change more rapidly.

79. The essential difference between whole-life and remaining-life depreciation rate calculations is that the former attempts to determine that annual charge that would be appropriate in the event that the current predictions of whole-life (estimated future life added to current experienced or expired life) were in fact correct. The remaining-life process proceeds on the premise that the current prediction of remaining or prospective life is correct and attempts to allocate any unrecovered or unallocated costs over that time period. That is, the original cost less accumulated reserve, or net unrecovered cost is divided by the prospective remaining-life in order to determine the annual future charges to expense.

80. One requisite for application of remaining-life rates is the ability to determine the current net unrecovered cost. The current reserve for depreciation attributable to the particular book balance of investment must be known if net unrecovered cost is to be determined. Such reserve balances are not available for the AT&T companies.

81. Currently, theoretical measures of the adequacy of carrier book reserves (that is, what the reserve should be based upon current predictions of remaining-life of investments and probable future accruals or allocations of investment costs) indicate that lives have been shortened substantially over previous estimates. The net result is that past allocations of costs to operating periods have been inadequate. If corrective action is not provided for, then at some future date, there will remain on the carrier's books of account a net plant balance, although the physical assets themselves will have been retired from service. Therefore, we will amend our Rules to indicate that, when necessary, we will permit the use of remaining-life depreciation rate calculations.

82. As with any change in the manner of calculating annual expense allocations of such very substantial amounts of money, the application of remaining-life might result in sharp increases in revenue requirements and in user charges. We therefore direct the staff to keep the Commission fully informed as to the difference in amounts of annual charges involved in any recommendations for prescribed rates that it might make. For at least a period of three years, we require that all rates recommended for prescrip-

tion carry with them a statement of the dollar impact in terms of annual expense, as between the rates calculated under the whole-life concept and under the remaining-life concept. Thereafter, the staff is to advise the Commission as to such differences whenever the proposed remaining-life rates result in an increase in proposed annual charges of 115% or more than the increase in annual charges arrived at by calculating whole-life rates.

83. With respect to telecommunications investment, the impact of new technology and the transition from a monopoly to a competitive environment have led to an overall shortening of life estimates. If the currently estimated shorter lives had been known all along, then past depreciation rates would have been higher even under the timing pattern of SLVG, and current reserves would be higher. Absent a reversal of current trends and without corrective action, the amount of difference due to errors of life estimate will continue to grow, and upon ultimate retirement the reserve provisions will not be adequate. It is for this reason that the Commission makes the choice that it must regarding the charging of costs to current and future periods.

84. For those carriers that do not maintain book reserves in sufficient detail to calculate remaining-life rates (e.g., the Bell Operating Telephone Companies), we direct the staff to determine, as expeditiously as possible, the most reasonable allocation of the current book reserves to plant categories. Furthermore, we direct these and all other subject carriers to maintain their book reserves in sufficient detail to allow the determination of depreciation rates by the remaining-life technique for subclasses of property for which depreciation rates are used. It is our desire that these actions not be delayed and that the corrective measures of remaining-life rates be implemented as soon as practicable. It is also our desire that the staff analyze the consequences of alternative reasonable allocations with respect to probable effects on revenue requirements, on the impact of increased expenses on various user groups, and on the incentives for company management to undertake accurate life estimates and to make investment decisions that will promote the public interest.

XI. Special Consideration of Present Investment in Account 232-Station Connections

85. In Docket 79-105, also addressed today, we consider the propriety of continuing the present practice of capitalizing amounts expended in the connection and reconnection of customer station apparatus. This consideration arose out of the findings in Docket 19129. In particular, the amount so invested or capitalized was growing at an extraordinary rate in comparison to growth in other plant investment categories.[6] This was in part due to the accounting treatment of disconnections and reconnections (churning of connections) and in part due to the concept that as such, connections had no particular age life relationship to retirements. The net effect was that annual charges to depreciation expense were designed to offset only the net retirements of any year (disconnects less reconnects), thus resulting in a zero reserve balance. In Docket 19129, it was found that the ultimate effect of this depreciation treatment was not significantly different from the long rejected concept of retirement accounting. Under this concept, annual depreciation charges cover only the year's net retirements and include no provision for the consumption within the year of a portion of the investment in assets still surviving[.][7]

86. In Docket 79-105, we concluded that there is a substantial difference in physical characteristics between the outside or service wire portion of the connection (otherwise referred to as the drop and protector block) and the inside or customer premise portion of connections. In that proceeding we also found that there is not only a strong case for the expensing of the expenditures for the inside portion of the wiring, but also for considering the inside portion to be a part of customer premises equipment rather than a part of carrier plant. To that end, we are issuing in that docket a further notice of proposed rulemaking regarding the detariffing of inside wiring. Because separate accounting treatment of the inside wire is appropriate under either continued

[6] See Final Decision in Docket No. 19129, para. 136. (64 FCC 2d 1, 55 (1977)).

[7] See Initial Decision in Docket No. 19129, paras. 717, 718 and 722. (64 FCC 2d 131, 355-356 (1976)).

expensing or full detariffing we directed in Docket 79-105 that property or investment in Account 232 should be separated into two parts, viz. that representing the outside or company provided customer service wire portion and the inside or customer premise portion of the connection.

87. There are significant differences in the factors affecting the probable service lives of the outside and inside portions of the investment. The outside portion is more subject to the actions of the elements and is also more subject to the actions of public authorities. The inside portion is more susceptible of the vagaries of customer preference, rather than actions of wear and tear, or the elements. In Docket 79-105 we asked the staff to work with the carriers to separate the present investment in Account 232, Station Connections, into its two primary parts as identified herein. We herein direct the staff to then proceed to develop appropriate allocations of the reserve for depreciation and an appropriate depreciation rate for each new investment category. Records are to be in conformity with the requirements of our order in Docket 79-105, although further accounting changes may be necessary to implement the policies adopted in both Docket 79-105 and this docket.

88. The staff and company experts continue to use the negative exponential curve as the basis for prescribing depreciation rates for investment in station connections. This results in a variant of retirement accounting and as such is inconsistent with our general depreciation policy that investment costs be spread in accordance with the straight-line concept over the service life of the asset. Absent further direction in Docket 79-105, the staff should promptly develop a different approach to the calculation of depreciation rates for this investment so that reasonably equal portions of investment will be charged to each of the expected years of the investment's life. This in turn should lead to the development of a positive reserve balance as opposed to the zero balance presently achieved.

XII Conclusions — FCC Policy — Rules — Interpretations

89. It is important to attempt to measure as accurately as possible the consumption of capital in a capital intensive enterprise. Of necessity, however, the measurement process cannot be achieved with absolute precision. Because of this lack of absolute precision, the application of reasoned judgment is often necessary. In practice, there has been a tendency to interpret our rules more restrictively than the actual language requires.

90. With the exception of some modest adjustments, the Commission's rules are for the most part more than adequate. The rules neither condone nor deny introduction of such further refinements as the ELG method, capital recovery schedule methods, or the corrective processes of calculating annual charges by use of the remaining-life concept. In fact, the Commission's rules call for the assignment or allocation of service values over service life, and absent fully compensating changes in life estimates, the use of something akin to remaining-life processes is necessary if those rules are to be satisfied.

91. We have discussed our long-standing preference for group procedures. We have noted that some parts of the rules explicitly provide for remaining-life techniques. The rules also indicate a preference, if not a requirement, that service values be spread over service lives by means of a straight-line method. Appropriate changes to the present rules will be ordered to permit more flexibility in the choice of particular procedures, methods, or techniques used and to correct any inconsistencies in the various parts of our rules. At the same time, we do not wish to foreclose reasonable considerations of alternative methods, applications and measures. To this end, the staff is directed to entertain and analyze such alternative proposals and to make recommendations to the Commission as the appropriateness of the proposals and the resultant depreciation rates.

92. We recognize that any change in accounting methods is not without cost. The implementation of changes may require the company and the commissions involved to devote more resources to the depreciation rate prescription process. Changes may result in increased revenue requirements and lead to rate increases. We

do not find increased rates inconsistent, *per se*, with our mandate, under Section 1 of the Act, "to make available . . . a rapid efficient, nation-wide, and world-wide communication service with adequate facilities at reasonable charges . . . " 47 U.S.C. § 151. We must balance the interests of all present and future customers in the preservation of adequate facilities at reasonable charges. On balance, we find it not unreasonable that present ratepayers incur some additional expense in order to preserve the integrity of the investment and to assure the continued and longer term satisfaction of the requirements of our congressional mandate. The only alternative, continued deferral of both recognition of current costs and initiation of corrective measures to rectify any past unrecovered costs, will require much larger adjustments to be made at some future date.

93. The unit summation (equal life group) process is nothing more than an extension or furtherance of the presently utilized straight-line vintage group method. Its adoption for new property additions would facilitate allocation of costs on a straight-line basis. Alternative methods may also achieve a similar pattern of cost assignment. These alternatives, including the capital recovery schedules concept, might be more appropriate for carriers lacking either the extensive data bases of the larger companies or the sophisticated data processing resources of those companies. Therefore, we will permit the utilization of ELG and alternative methods at the carrier's option, with the provision that implementation must be under the supervision of our staff. The staff will take such measures as may be necessary to insure that proper reporting, record keeping, underlying support data and ultimately measurability and accountability of results are attained.

94. As discussed above, corrective measures are necessary in order to match the recovery of the costs of assets with the service life of the assets themselves. These corrective measures are just as necessary for the present SLVG investments as they are for the prospective investments, whether to be treated under ELG, capital recovery schedules, or some other means. The staff, with the cooperation of the companies, should develop remaining-life rates for both present and prospective plant investments, and present the same to the Commission for consideration. As some carriers

lack the requisite plant category of investment book reserves, the staff should proceed immediately to develop and implement such reserves by allocation of the present overall company reserves. Furthermore, in accordance with Part 31, Section 171 of the Rules, these carriers will maintain their book reserves by accounts corresponding to the depreciable plant accounts.

95. Additionally, the Commission has reiterated its intentions regarding the depreciation of the investment in Account 232 as set forth in its decision in Docket 19129. The Commission finds that its intentions, that this account be depreciated in accordance with the straight-line concept as generally understood, are not being met. Absent further direction in Docket 79-105, the Commission directs the staff to proceed immediately to overcome this problem by developing appropriate means of assuring that the depreciation rates for this account will in fact apportion relatively equal amounts of investment to each of the several years during which the investment remains in service.

96. Lastly, the Commission chooses to address the proper role of staff in the analysis and assessment of carrier proposals for depreciation rates. Depreciation rate proposals and supporting data and analyses are submitted to the Commission by carriers who obviously have a significant financial interest in the rates which are ultimately prescribed. As a result, it is essential for the staff to review them with a healthy skepticism; however, the staff must not lose sight of the primary goal of the process which is to distribute the full cost of an asset in a reasonable manner over its service life. To achieve this goal the staff must aim at the most accurate measurement of lives and salvage values reasonably attainable. To do otherwise would be misleading to the regulators having to reach final ratemaking decisions, and could result in improper conclusions to the detriment of both customers and investors. In arriving at its reasoned judgments, however, the staff must analyze the probable consequences vis-a-vis our paramount public interest perspective.

97. In addition to reports regarding appropriate lives, salvage percentages, and depreciation rates, the staff should advise the Commission of any questionable carrier activities or practices

affecting depreciation rates which come to light during the course of the staff investigations.

XIII Ordering Clauses

98. Accordingly, IT IS ORDERED, pursuant to Sections 4(i), 4(j), 220, of the The Communications Act of 1934, as amended, that the policies and rules set forth herein ARE ADOPTED as a final decision in Docket No. 20188.

99. IT IS FURTHER ORDERED THAT Parts 31, 34, and 35 of the Commission Rules ARE HEREBY AMENDED, effective July 1, 1981, as reflected in the Appendix.

100. IT IS FURTHER ORDERED THAT the Final Report issued by Ernst & Ernst under contract to the Commission, which was dated July 29, 1977, together with comments thereon submitted under the aegis of FCC Public Notice No. 88859, dated September 8, 1977, are incorporated into the record of this proceeding.

101. IT IS FURTHER ORDERED THAT Docket No. 20188 is HEREBY TERMINATED.

102. IT IS FURTHER ORDERED THAT The Secretary shall cause a copy of this decision to be published in the Federal Register.

FEDERAL COMMUNICATIONS COMMISSION,
WILLIAM J. TRICARICO, *Secretary*.

Appendix 1.

1. In Part 31, Section 31.02-80, (a) is amended and (d) is added to read as follows:

§ 31.02-80 Computation of depreciation rates.

(a) Unless otherwise provided by the Commission, either through prior approval, or upon prescription by the Commission, depreciation percentage rates shall be computed in conformity with a group plan of accounting for depreciation and shall be such that the loss in service value of the

property, except for losses excluded under the definition of depreciation, may be distributed under the straight-line method during the service life of the property.

* * *

(d) Companies, upon receiving prior approval from the Commission or, upon prescription by the Commission, shall apply such depreciation rate as will amortize the difference between the net book cost of a class or sub-class of plant and its estimated net salvage during the known or estimated remaining service life of that plant.

2. In Part 31, Section 31.171, (c) is amended to read as follows:

§ 31.171 Depreciation Reserve.

* * *

(c) The company shall maintain this account broken down by accounts corresponding to the classes of depreciable telephone plant accounts itemized in Part 31, Section 31.02-82. These accounts shall show the current credits and debits to the reserve in complete detail.

3. In Part 34, Section 34.04-2, (d) is added to read as follows:

§ 34.04-2 Computation of depreciation rates.

* * *

(d) The Commission's preference is that depreciation rates and charges be calculated by application of a generally accepted group method applied in a manner to accomplish a straight-line allocation of service value. However, a carrier, upon receiving prior approval from the Commission or, upon prescription by the Commission, may apply depreciation rates determined by use of other methods or allocation patterns.

4. In Part 35, Section 35.04-2, (d) is added to read as follows:

§ 35.04-2 Computation of depreciation rates.

* * *

(d) The Commission's preference is that depreciation rates and charges be calculated by application of a generally accepted group method applied in a manner to accomplish a straight-line allocation of service value. However, a carrier, upon receiving prior approval from the Commission or, upon prescription by the Commission, may apply depreciation rates determined by use of other methods or allocation patterns.

FCC 81-350

BEFORE THE

FEDERAL COMMUNICATIONS COMMISSION

Washington, D.C. 20554

Docket No. 20188

In the Matter of

Amendment of Part 31 (Uniform System of Accounts for Class A and Class B Telephone Companies) so as to permit depreciable property to be placed in groups comprised of units with expected equal life for depreciation under the straight-line method.

ORDER ON RECONSIDERATION

(Adopted: July 30, 1981; Released: August 18, 1981)

BY THE COMMISSION: COMMISSIONER WASHBURN ISSUING A SEPARATE STATEMENT; COMMISSIONER FOGARTY ISSUING A SEPARATE STATEMENT IN WHICH COMMISSIONER QUELLO JOINS; COMMISSIONER DAWSON ABSTAINING FROM VOTING.

1. Introduction

1. On December 5, 1980, the Commission released its *Report and Order* in Docket No. 20188, 83 FCC 2d 267 (1980), to permit Class A and B telephone companies to use Straight Line Equal Life Group (SLELG) and remaining-life depreciation procedures. A Petition for Reconsideration was filed on February 26, 1981, by the National Association of Regulatory Utility Commissioners (NARUC). Oppositions to this Petition were filed by GTE Service Corporation (GTE) and the American Telephone and Telegraph Company (AT&T). A Reply to these oppositions was filed by NARUC. A Petition for Clarification was filed on February 13, 1981, by GTE. An Opposition to this Petition was filed by NARUC on March 30, 1981. GTE replied on April 13, 1981. Each of these petitions will now be considered.

II. NARUC's Petition

2. In its petition NARUC argues that the changes adopted in the Commission's *Report and Order*, namely, the adoption of SLELG as an approved depreciation method for new plant and the use of remaining-life for embedded plant, will substantially increase revenue requirements and thereby subscriber rates and that the Commission should therefore reconsider the disadvantages of these changes in light of the already increased revenue requirements brought about by its decisions in *Computer Inquiry II* and *Docket No. 79-105* (Expensing of Station Connections).[1] NARUC argues that the SLELG method is no more accurate than the currently used Straight Line Vintage Group (SLVG) method; that the SLELG method is accelerated in comparison with SLVG; that the adoption of SLELG will result in increased costs for both telephone companies and state commissions because of difficulties in implementation; that SLELG depreciation procedures will increase the advantages which large companies held over their smaller competitors; and that the inadequacies of the current SLVG whole-life procedure might be cured by more realistic estimates of the life of depreciable property[2], disaggregated salvage estimates and more homogeneous groupings of plant.

3. AT&T and GTE in their opposition to NARUC's Petition for Reconsideration note that NARUC's arguments against SLELG are the same arguments it has made repeatedly throughout this proceeding. They state that these arguments have already

[1] For the *Second Computer Inquiry See In the Matter of Amendment of Section 64.702 of the Commission's Rules and Regulations* (Final Decision), 77 FCC 2d 384 (1980), *recon. in part*, 84 FCC 2d 50 (1980). For the Expensing of Station Connections *See In the Matter of Amendment of Part 31, Uniform System of Accounts for Class A and Class B Telephone Companies, of the Commission's Rules and Regulations with respect to accounting for station connections, optional payment plan revenues and related capital costs, customer provided equipment and sale of terminal equipment*, 85 FCC 2d 818 (1981).

[2] NARUC suggests in this regard that equipment lives are largely under the control of the major telephone companies.

been considered by the Commission and rejected. Further, AT&T observes that if circumstances have changed since comments were filed, NARUC has not cited them in support of its Petition. Accordingly, they request that the Commission deny NARUC's Petition for Reconsideration.

4. We agree with AT&T and GTE that NARUC's arguments for reconsideration were fully considered by the Commission in reaching its original decision. Having no new arguments or facts before us, and believing that our original decision was sound, we reject NARUC's Petition for Reconsideration as discussed below.

5. NARUC argues that we have not given adequate consideration to the increased revenue requirements, and ultimately carrier rates which would be generated by the change in depreciation methods we have ordered. Under normal circumstances it is settled law that capital prudently invested in a regulated public utility must be recovered through annual charges to depreciation expense. The depreciation process spreads this recovery over the average estimated service life of the various plant categories in such a way as to provide full capital recovery. The only question addressed in this proceeding is the speed at which this recovery will occur; i.e., the allocation of the cost among present ratepayers and future ratepayers. The Commission has recognized, as have all parties to this proceeding, that the change to SLELG would result in higher revenue requirements initially and, thereby, higher customer charges. Under the circumstances here, as we found in the original decision, increased revenue requirements for an initial period are not *per se* inconsistent with our mandate under Section 1 of the Act "to make available . . . a rapid, efficient, Nation-wide, and world-wide . . . communication service with adequate facilities at reasonable charges . . . . " 47 U.S.C. § 151. We are convinced that we have taken the appropriate steps to bring the communications carriers depreciation reserve and future recognition of depreciation expenses more in line with actual rates at which the assets are being consumed and more in line with today's technology and economic conditions. We believe that the public will benefit from enlightened accounting and depreciation policies which encourage technological innovation.

The impact of these increases will be ameliorated by the phase-in of SLELG directed in our *Report and Order*.

6. NARUC suggests that more reasonable life estimates, disaggregated salvage estimates, or more homogeneous accounts could alleviate the problems with SLVG. These arguments miss the mark. NARUC appears to be suggesting that inaccurate life estimates be made in the depreciation rate-setting process to compensate for the inadequacies in SLVG. The better approach, and the one adopted by the Commission, is to continue to make the most accurate life estimates possible and to change the depreciation method to more accurately provide for capital recovery at a rate representative of the actual consumption of the property. The difference between SLELG and SLVG is in the approach taken to spreading the service value over the estimated average service life of the assets comprising the depreciation category, not in the estimation of average service lives. The average service life under either approach will be the same. As our *Report and Order* found, straight line depreciation is generally the preferred method. SLVG is a decelerated depreciation method when compared with the depreciation that would result if straight line unit depreciation were used. While such a decelerated method might have been acceptable in a monopoly environment, the delayed capital recovery under such a method has become less attractive with the increase in competition which has developed over the past decade. Therefore, changing the life estimation process will not correct SLVG's deficiencies. Furthermore, we do not believe that the disaggregation of salvage estimates will correct these deficiencies. NARUC has not indicated how this change in salvage estimation procedures would in any way significantly shift capital recovery over the average service life of a depreciation category. Given the existing Uniform System of Accounts for telephone companies contained in Part 31 of the Commission's Rules, 47 C.F.R. § 31.01-1 *et seq*, the development of more homogenous depreciation categories is infeasible because of a lack of sufficient plant disaggregation. Therefore, NARUC's alternatives would not deal with the need to improve capital recovery promptly in light of competitive and technological conditions in the marketplace.

7. NARUC's claim that the large companies control technological change, and therefore service lives, is equally unavailing with respect to the question of depreciation method. Rather, the control argument addresses problems of life estimation, which, as we have previously noted, are common to both SLELG and SLVG. This is not to say that the selection of a depreciation method may not indirectly affect the rate of equipment replacement but only that these indirect effects are insufficient to outweigh the need for improved capital recovery.

8. It is likely, as NARUC contends, that the adoption of SLELG will increase somewhat the demands on commission staffs. This is unavoidable if adequate capital recovery is to be assured. An orderly transition in depreciation rate prescription procedures must be established if commissions are to fulfill their obligations to ratepayers and the companies they regulate, and this obviously requires some additional expenditure of staff resources. We believe that the phased implementation approach balances the capital recovery and staffing problems in a reasonable way. NARUC has not presented a viable alternative that would further reduce staffing costs while assuring adequate capital recovery.

9. NARUC's argument as to the potential impact on small carriers is also not persuasive. We did not mandate that all carriers must use SLELG. Therefore, if a small company feels that the new methods would have an adverse impact on its operations it can continue with its present method. Furthermore, we find no competitive inequity in this result since, as AT&T notes, the smaller carriers in most instances are not competing with the larger carriers.

III. *GTE's Petition*

10. In its Petition, GTE sought clarification on several points, including the manner in which the depreciation changes would be implemented. Specifically, GTE has requested the following "clarifications":

(1) Amendment of Section 31.02-80 to correspond with related sections of Parts 34 and 35 to indicate similarity of treatment for all carriers;

(2) Amendment of Section 31.171(c) to provide for the recognition of the possibility of separate reserves for original cost and net salvage;

(3) Adoption of a policy requiring a decision within ninety days of the filing of depreciation represcription requests;

(4) Change of the implementation of SLELG to allow outside plant and central office equipment to be prescribed in 1981 effective January 1, 1982, with remaining-life rates for all accounts to be prescribed in 1981.

(5) Adoption of a zone of reasonableness to be applied to recurring filings; and

(6) Deletion of the policy requiring whole-life and remaining-life submissions after the first three year represcription period.

NARUC has opposed GTE's Petition in substantial part. Each of GTE's requests, as well as NARUC's objections, is considered *seriatim* below.

11. *Amendment of Section 31.02-80.* GTE proposes revised language for Section 31.02-80 that it feels will reflect the intent of the Commission more precisely and will indicate that the Commission intended the same policy to apply to Part 31 as applies to Parts 34 and 35. In the original decision, Section 31.02-80(a) was amended to read:

> Unless otherwise provided by the Commission, either through prior approval, or upon prescription by the Commission, depreciation percentage rates shall be computed in conformity with a group plan of accounting for depreciation and shall be such that the loss in service value of the property, except for losses excluded under the definition of depreciation, may be distributed under the straight-line method during the service life of the property.

GTE proposes to amend subparagraph (a) to read:

> The Commission's preference is that depreciation rates and charges be calculated by application of a generally accepted group method applied in a manner to accomplish a straight-line allocation of service value. However, a carrier, upon receiving prior approval from the Commission or, upon prescription by the Commission, may apply depreciation rates determined by use of other methods or allocation patterns.

NARUC believes that accelerated methods are rarely advisable in the regulated environment and would require a carrier seeking an alternate method to bear the burden of clearly and convincingly demonstrating that such method is superior to the straight-line method. NARUC seeks incorporation of this standard as part of the Rule.

12. GTE has correctly noted that a language discrepancy exists between Part 31 and Parts 34 and 35. Although these language differences are not so diverse as to produce contrary results, the suggested change will clarify our intent to treat all carriers alike. We will therefore adopt GTE's suggested change. The deletion of the language "except for losses excluded under the definition of depreciation" from Section 31.02-80(a) adopted in the original decision is not significant. This caveat is the subject of Section 31.02-83[3] and is adequately covered by the language of that Section.

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[3] Section 31.02-83 provides in pertinent part:

> If the cause of retirement is not a recognized factor in depreciation and the loss is not covered by insurance, the company may upon proof that the charge to the depreciation reserve will result in undue depletion thereof, and with the approval of this Commission, credit account 171, "Depreciation reserve," and charge account 138, "Extraordinary maintenance and retirements," with the unprovided-for loss in service value and distribute it from that account to account 609, "Extraordinary retirements," over such period as this Commission may approve.

13. In paragraph 70 of the orignial decision the Commission indicated that "[t]he burden of demonstrating that any particular method is both reasonable and practicable for the purposes of meeting the requirements of depreciation accounting is upon the carrier seeking approval of such method or application." 83 FCC 2d at 287. We believe that this statement of policy when read with the prior approval language of Section 31.02-80(a), as amended herein, is adequate to allay NARUC's concerns. We would agree, nevertheless, that any alternate depreciation method must be consistent with the public interest objectives expressed in Section 1 of the Act.

14. *Amendment of Section 31.171(c)*. GTE proposes revised language to be incorporated into our amendments to Section 31.171(c) to authorize the use of separate reserves for original cost and net slavage.[4] GTE argues that its proposed change would allow precise recovery of each vintage of original cost and, at the same time, allow adjustments for proper levels of annual cost of removal and salvage. As GTE points out, paragraph 52 of the original decision recognizes that it may be necessary to keep accumulated depreciation at different levels of aggregation for original cost and for net salvage in order to implement SLELG. If that is done by a carrier, separate reserves for original cost and net salvage for each depreciable plant category will be required.

[4] GTE proposes adding the following to paragraph (c):

Each carrier may separate accounting for salvage from depreciation accounting. For the purpose of accounting for salvage, each carrier shall either:

(a) accrue annually for the estimated net salvage proceeds during the life of the assets, or

(b) recognize net salvage as realized, provided that the carrier has satisfied the Commission that such accounting treatment would not have a significant impact on the financial results of the carriers. The selection of one of the above accounting treatments for each class of asset shall not be altered without prior Commission approval. If, in a given year, a carrier should experience extraordinary cost of removal or gross salvage, the carrier shall immediately advise the Commission which, after consulting the carrier, will determine an appropriate course of action.

Section 31.01-2(d)(1) allows carriers to keep additional subaccounts as long as the integrity of the accounts is maintained. Accordingly, it is not necessary to specify that additional subaccounts may be kept. Furthermore, we are not convinced that the two options set forth in GTE's proposal are consistent with the Commission's intentions as set forth in paragraph 52. GTE has not described, in any detail how either of the two alternatives suggested would be implemented, nor has it supplied the revenue requirement effects of either option. However, it appears that both methods may result in a decelerated recognition of salvage effects. In fact, the second alternative could possibly be intended to place the accounting for net salvage outside the depreciation process. This was clearly not contemplated by the Commission, nor has GTE justified the adoption of such an approach. In light of GTE's failure to adequately support its proposal, and the Rule proviso permitting additional subaccounts, we believe the detailed implementation of our order is best handled by the staff of the various commissions working with the carriers. This will allow the carriers and the commission staffs to implement plans that will best meet the needs and conditions of each of the carriers and commissions. If additional subaccounts are necessary, they may best be selected once the implementation methods have been established.

15. *Ninety Day Deadline.* GTE has requested that the Commission adopt a policy of acting on represcription applications for SLELG and remaining-life not later than ninety days following submission. GTE maintains that its companies need a response within this time frame to avoid adverse financial consequences from depreciation rates being implemented on a retroactive basis. In its opposition NARUC argues that the urgency that GTE refers to in its Petition is purely fictional because not only is the use of SLELG and remaining-life optional for all carriers, but the retroactive effectiveness of any approved depreciation rates is also optional. NARUC suggests that GTE adopt a flexible approach in implementing the increases by coordinating the timing and the implementation of a SLELG/remaining-life changeover with the effectiveness of tariffs reflecting these revenue requirement increases. NARUC also argues that a ninety day time limit for

action on a represcription request could affect the inclusion of the states in the three-way meetings.

16. GTE's argument on the adverse impact of the retroactive application of depreciation rates is not well-founded. Section 43.43 of the Rules, 47 C.F.R. 43.3, provides for the filing of requests for depreciation rate changes at least ninety days prior to the last day of the month with respect to which the revised rates are first to be applied in the accounts. It also states that the application shall state the date on which the rates are to be made effective. There is nothing in the Rules that prevents a carrier from filing its application more than ninety days prior to the last day of the month with respect to which the revised rates are first to be applied in the accounts. Subsection (e) which provides for retroactive application of the depreciation rates to the beginning of the year is permissive, not mandatory.[5]

17. This commission is charged with the responsibility of approving depreciation rates for communications carriers subject to Section 220(b), 47 USC 220(b). In this *Docket*, we have adopted a change in depreciation methods that the carriers will be allowed to use (SLELG) as well as revised the existing procedures that can be used with embedded plant (remaining-life). These changes will create a large number of filings for both SLELG rates and remaining-life rates. It would be unwise for us to adopt a strict time frame for responding to represcription requests when we are sure that our staff work load, as well as that of the states, will increase significantly in the very near future. Moreover, at a time when such major changes are being put in place we believe, contrary to GTE's contention, it is prudent to continue active state involvement in the three-way meeting process.[6] A ninety day restriction could easily limit this Commis-

[5] Section 43.43(e) provides that "such rates may be made retroactive to a date not prior to the beginning of the year in which the filing is made. . . . "

[6] This is not to say that three-way meetings are required by statute. Although this question is not before us, it is possible that other forms of state participation would satisfy the requirements of Section 220(i), 47 USC 220(i).

sion's ability to properly discharge its responsibility to set depreciation rates. We note that in the past our approval time on represcription requests has been close to the ninety days that GTE requests. However, this was prior to our adoption of the option of SLELG and remaining-life depreciation procedures. We were able to respond to a depreciation rate request in this time frame in prior periods because of the cooperation of the carriers and commission staffs. We will continue to work with the carriers and strive to resolve, with the concurrence of the states, all depreciation filings on a timely schedule. However, we will not bind ourselves to a deadline which may, in certain cases, not allow for adequate consideration of the rates filed. To commit ourselves in such a manner would not be consistent with our overriding obligation to protect the public interest.

18. *Timing of implementation of new methods.* GTE has requested that we review and approve new SLELG depreciation rates for both the outside plant and central office equipment accounts in 1981 to allow GTE companies to implement the new rates effective January 1, 1982. GTE also requested that we review and approve new remaining-life depreciation rates for all accounts in 1981. It argues that if approval of new rates is made retroactive, it may be forced to bear the additional expenses without the opportunity to collect the increase in revenue requirements. NARUC points out that there is no requirement that GTE make any depreciation rates effective retroactively and in fact the carriers could coordinate the implementation of the new depreciation methods with filings for additional revenues with the respective state commissions.

19. GTE has also raised the problem of "retroactivity" in connection with its "timing" argument. As we noted in paragraph 16, however, retroactivity is optional with the carrier and there is little possibility that it will be forced to bear expenses that it is unable to collect because of a retroactive application of depreciation rates. Furthermore, as we noted in our *Report and Order*, 83 FCC 2d at 284-5, one of the primary reasons we adopted a phase-in of SLELG was the added burdens its implementation will place on regulatory bodies. The adoption of remaining-life depreciation procedures compounds the work requirements on these

staffs, especially during the transition years. We realize that the carriers have a financial interest in obtaining as rapid approval of new depreciation rates as possible. On the other hand, the regulatory commissions have the responsibility of assuring themselves that the requested rates properly reflect the consumption of capital for the various items of plant. NARUC's Petition for Reconsideration also notes that implementation of our *Report and Order* will place additional burdens on the majority of the state commission staffs. These additional staff efforts are caused by the simultaneous adoption of SLELG depreciation methods and remaining-life procedures. We fully intend to work with the state commissions to ensure that the new rates prescribed for both SLELG and remaining-life are properly supported. In general, where circumstances permit, we intend to use the three-way represcription meetings to prescribe new remaining-life rates.

20. In the *Report and Order* the staff was directed to address the adoption of SLELG for new additions to outside plant in 1981, for new additions to central office equipment in 1982, and for new additions to the remaining categories of plant in 1983. Given the limited availability of staff resources, there is uncertainty as to whether the first step in implementation of SLELG rates can be accomplished in accordance with this schedule; nevertheless, the staff is directed to make every effort to meet these objectives.

21. *Adoption of a Zone of Reasonableness.* GTE has proposed filing annual remaining-life adjustments and has urged that as long as the rates requested are in a "range of reasonableness" that the requested rates be approved without detailed analysis. The company argues that nothing in our *Report and Order* precludes annual filings, and detailed analysis of these filings is no longer required because the use of remaining-life will assure recovery of no more than the full investment. NARUC, on the other hand, contends that the range of reasonableness approach by GTE appears to advocate a rubber-stamp approach and abandons the three-way meeting process.

22. GTE has not defined "zone of reasonableness" nor has it discussed how such a concept would be implemented. It is unclear how the zone of reasonableness is to be determined, what

guidelines would determine when the zone would be changed, and whether a similar zone would apply to all plant categories. Moreover, GTE's concern should affect only a limited number of depreciation categories, i.e., those with the shortest remaining-lives. With the instructions to the staff contained in paragraph 23, we believe adequate staff flexibility exists to accommodate any short term implementation considerations. Furthermore, as we observed in our original decision, Section 220(b) of the Act requires the Commission to prescribe any changes in depreciation rates. To the extent GTE's proposal would allow a carrier to change a rate without a Commission prescription, questions arise as to its lawfulness under Section 220(b) of the Act. Accordingly, the adoption of a zone of reasonableness at this time is unnecessary, and would be infeasible without more detailed specification and public comment thereon.

23. GTE observed that nothing prohibits it from filing annual remaining-life represcription requests to reflect the decline in the average remaining-life of any depreciable plant category. NARUC considers such annual filings to be impractical. We recognize the potential impact upon both state and federal commissions involved in any such annual filings. However, the Commission does not intend to preclude the staff or the carriers from pursuing any implementation procedures which will expedite the depreciation ratemaking process. In fact, the Commission continues to encourage participants in the process to seek approaches that will minimize the filing burdens while ensuring that the Commission's statutory responsibilities are satisfied.

24. *Deletion of Parallel Whole-life/Remaining-life Submissions After First Represcription Period.* GTE urges the Commission to consider revising its statement in paragraph 82 requiring the submission of both whole-life and remaining-life studies beyond the initial three-year represcription. GTE submits that these studies are not in the spirit of deregulation and are largely duplicative. NARUC has not opposed this request.

25. A reading of paragraph 82 indicates that continuing studies under both methods would be necessary to determine whether "the proposed remaining-life rates result in an increase in proposed annual charges of 115% or more than the increase in

annual charges arrived at by calculating whole-life rates." 83 FCC 2d at 290. Whenever this occurs, the staff is to advise the Commission. On reconsideration, this general continuing requirement to file whole-life and remaining-life studies does appear to be overly burdensome since no whole-life depreciation rates would be prescribed and the procedures outlined below will be adequate to spot those instances where continued parallel filings may be beneficial. Accordingly, at the time of the parallel filing for the first represcription the staff shall review the divergence between the two methods and report this to the Commission as required by paragraph 82. It shall also analyze the filings to determine whether deplicative filings for the next represcription will be beneficial, and, if so, the represcription order will set forth the requirement to be met. Otherwise, the parallel filing requirement will be discontinued for that company.

IV. *Ordering Clauses*

26. ACCORDINGLY, IT IS ORDERED, That the Petition for Reconsideration of the National Association of Regulatory Utility Commissioners is Denied.

27. IT IS FURTHER ORDERED, That the Petition for Clarification filed by GTE Service Corporation is Granted in Part to the extent indicated herein and otherwise Denied.

28. IT IS FURTHER ORDERED, That the Secretary shall cause a copy of this Order on Reconsideration to be published in the Federal Register.

29. IT IS FURTHER ORDERED, That under authority contained in Sections 4(i), 4(j) and 220 of the Communications Act of 1934, as amended, Part 31, Uniform System of Accounts for Class A and Class B Telephone Companies IS AMENDED as set forth in the attached Appendix.

FEDERAL COMMUNICATIONS COMMISSION,
WILLIAM J. TRICARICO, *Secretary*.

Appendix

Part 31, Uniform System of Accounts for Class A and Class B Telephone Companies, is amended as follows:

In Part 31, Section 31.02-80(a) is amended to read as follows:

(a) The Commission's preference is that depreciation rates and charges be calculated by application of a generally accepted group method applied in a manner to accomplish a straight-line allocation of service value. However, a carrier, upon receiving prior approval from the Commission or, upon prescription by the Commission, may apply depreciation rates determined by use of other methods or allocation patterns.

SEPARATE STATEMENT OF COMMISSIONER ABBOTT WASHBURN

IN RE: EQUAL LIFE GROUP DEPRECIATION PROCEDURES DOCKET NO. 20188

Our November 6, 1980 Report and Order[1] recognized there would be added work for this Commission, the State Commissions and the companies who will use the new depreciation procedures. Accordingly, we included a phased implementation of Equal Life Group (ELG) depreciation for new plant. Today the staff told us that with existing staff resources it is impractical to expect to meet the scheduled implementation of ELG for outside plant in 1981. The staff, nevertheless, was asked by the Commission to adhere to the original schedule to the degree possible.

It is much in the public interest, as we move into a competitive era in voice and data transmission, that companies be allowed to recover capital consistent with the realities of the new and rapidly changing technology. Therefore it would give the wrong signal as

[1] Amendment of Part 31 (Uniform System of Accounts for Class A and Class B Telephone Companies) so as to permit depreciable property to be placed in groups comprised of units with expected equal life for depreciation under the straight-line method. 83 FCC 2d 267 (1980).

to our firm intent, were we now to slip the schedule by a year, after having adopted it just seven months ago. We recognized in November that there would be a strain on our personnel.

However, with the massive tasks ahead and with but four Depreciation Rate Engineers on the Common Carrier staff, it would be unfair to expect miracles. These experts are of the highest caliber. They are putting forth extra effort to meet the goals set by the Commission. But clearly, as Chairman Fowler put it, they can't take the hill without reinforcements.

To help resolve the problem, I suggest:

- That the Commission, with all vigor, make more staff resources available—whether through reassignment, permanent additions, or hiring of consultants, as soon as possible.
- That the staff diligently pursue new and streamlined approaches and procedures.
- That the companies prioritize their filings and adopt realistic expectations during the difficult transition period.
- That the Commission review progress at a meeting during the fourth quarter of 1981.

SEPARATE STATEMENT OF COMMISSIONER JOSEPH R. FOGARTY

In Re: Amendment of Part 31 (Uniform System of Accounts for Class A and Class B Telephone Companies) so as to permit depreciable property to be placed in groups comprised of units with expected equal life for depreciation under the straight-line method.

I strongly support the Commission's decision to attempt to adhere to the original schedule for the implementation of the Equal Life Group (ELG) procedure for property depreciation. It is essential that ELG be implemented on schedule. Most telephone companies are currently operating with inadequate reserves, and further delay in the implementation of ELG would only serve to compound an already serious problem—a perennial

problem whose history suggests the remedy the Commission should adopt to avert a real disaster.

In our *Property Depreciation* Order adopted in November, 1980, we held that the ELG procedure was an acceptable method of straight line depreciation. *Property Depreciation*, 83 FCC 2d 269 (1980). Pursuant to the schedule established in that Order, telephone companies were permitted to implement ELG for new additions to outside plant during 1981, new additions to central office equipment (COE) in 1982, and new additions to the remaining categories in 1983. 83 FCC 2d at 285. In acknowledging the advantages of ELG, we stated:

> "if the public is to realize the benefits of advances in communications, it is necessary that accounting and depreciation rules not stifle innovation and inhibit the introduction of new technology." 83 FCC 2d at 281.

We found it crucial that the companies, their customers, and their investors, as well as the regulators, all have an accurate and objective financial picture of the companies' operations and capital requirements. The Commission concluded that the implementation of the ELG method of depreciation would play an important role in meeting this need because it appeared "to calibrate more closely the flow of revenues with the recovery of capital." 83 FCC 2d at 281. We found also that the use of ELG was in the public interest as it would enhance the ability of regulated telephone companies to continue to provide "... rapid, efficient... communication service with adequate facilities at reasonable charges." 83 FCC 2d at 281.

To delay implementation of ELG based on the fear that staff resources are not adequate to meet demands of the ELG implementation timetable would be the wrong solution. In addition to implementing the first phase of ELG, the Bureau, by the end of the year, must also prescribe remaining-life depreciation rate calculations for all of the 1981 companies, represcribe terminal equipment depreciation rates, and represcribe depreciation rates for station connections—other subclass of plant. However, ELG should not be sacrificed to these other demands. If *Computer II* is to be implemented and the telephone companies permitted to

enter the new age of competition with parity, all these depreciation changes—including ELG—should be implemented promptly, and by the end of 1981.

I agree with GTE that the Commission should review and approve new ELG depreciation rates for both outside plant and COE in 1981 to allow companies to implement the new rates on January 1, 1982. Telephone companies should not be forced to apply new depreciation rates retroactively and thereby run the risk of being unable to have the consequent increases in revenue requirements recognized in corresponding rate increases under state regulation. It is essential that depreciation rates be matched with revenue dollars.

I also agree with GTE's proposed "zone of reasonableness" concept under which it would file annual remaining life adjustments which would be approved as long as the requested rates fall within a "range of reasonableness." However, I believe that any further consideration of this point should be delayed until after the implementation of the first phase of ELG depreciation.

I am disappointed that the first time the Commission has had the opportunity to grapple with the actual implementation of our competitive common carrier policies, the staff recommended a one-year postponement of the imperative based on the claim that sufficient personnel to accomplish the job were lacking. If we fail to implement ELG now in a timely fashion because of lack of staff resources, our ability to implement *Computer II* is also put in question. If we were to indulge in a one-year delay to give the Bureau more time to analyze cost recovery issues, what would we face next year when the same staff will have the gargantuan task of valuating the $10 billion assets assigned to the new AT&T unregulated subsidiary? The summer of '81 would seem somnolent and easy going in comparison.

For this Commission to waver now in its commitment to accelerated capital recovery would not only be an embarrassment to the agency, it would indicate an ambivalence on our part and invite an attack on our decision to allow ELG and more rapid cost recovery, as well as our other competitive policies. For these reasons, it is imperative that Commission action in the capital

recovery area proceed promptly. I am pleased to comply with Chairman Fowler's request that I work directly with the Bureau to accomplish this critical task and propose later in this statement a procedure for the Commission to adopt to meet the necessary time-table.

This is not a commitment that I make either lightly or naively. The capital recovery issues to be faced are complex and may ultimately involve major depreciation policy changes. From the beginning, telephone company depreciation has focussed on the financial and accounting management of the capital investment of the largest and most capital intensive business in the world. While the economy enjoyed prolonged periods of relative economic stability and the industry enjoyed a *de facto* monopoly market, this Commission and state commissions believed it was in the public interest to delay timely capital cost recovery by the telephone industry. Regulators in effect substituted their judgment for that of telephone company management regarding depreciation in order to maintain low monthly customer charges.

The pace of technological development, escalating inflation, the erosion of monopoly protection by the introduction of competition into the field of telephony—all have joined to destroy the peaceful, permissive atmosphere which previously existed.

The telephone industry faces a crisis. Present and prospective capital investments of the industry are endangered now by procrastination and delays in timing of cost recognition. These dangers are real and they pertain to the entire industry—from AT&T to the smallest of the Independents. The crisis has been heightened by recent decisions of the Commission to deregulate substantial areas of telephone equipment which represent a substantial investment.

In this docket, we did identify capital accounting measures and means to attack the problems of past and current deferral of those costs. Nevertheless, the Commission unfortunately bogged down in the effort to adopt remaining life rates and modernize straight-line allocation of costs. In my view, the principal cause of this crippling delay is the Commission's unyielding adherence to prolonged exercises in the estimation of lives, together with

attempts to develop and impose finite controls to assure absolute precision. The delays are unwarranted precisely because this whole process is one of estimation and not one of precision. The only control over the process that this Commission need exercise is to assure that no more than 100% of costs be recovered. Current measures of recovery fall far too short. The Commission's past record of achievement in the area of cost recovery is inadequate. Yet, the Commission still appears determined to resist needed changes—to hold down revenue requirements for yet a while longer—to postpone the inevitable.

The only solution to this problem, I believe, is for the Commission to move forward expeditiously, with the cooperation of state regulatory agencies and the carriers to implement corrective cost recovery measures needed now—not later. Deferral of action is dangerous and will compound the massive problem that must be confronted.

Although the Communications Act (47 U.S.C. 151 *et. seq.*) charges the Commission with the sole responsibility to prescribe accounting methods and depreciation rates to be followed by subject carriers (47 U.S.C. 220) and affected states must be afforded an opportunity to comment, the rulemaking process does not require prolonged notice and hearing (5 U.S.C. 553). I have consistently encouraged dialogue and development of an efficient working relationship with the states. In more tranquil times, the traditional three-way meetings, among the FCC, the carriers and the state regulatory commissions, proved to be an excellent means of assessing the position of the states. Now, however, the exigencies of the times, the lack of sufficient Commission funding and staff resources require that we find a more efficient means of implementing cost recovery procedures than the venerable tripartite meetings.

This requires that regulators and the industry cooperate in an effort to resolve the problem of capital recovery. Action must be taken by the end of 1981 or we will lose control of the situation.

The only solution with merit that I have found is for the Commission to establish a working group in the Common Carrier Bureau, similar to the group of parties in interest which negotiated the ENFIA arrangement. *Exchange Network Facilities (ENFIA)*, 71 FCC 2d 440 (1979). This Cost Recovery Group under the supervision of an FCC Commissioner would be composed of the parties in interest: NARUC, the subject carriers represented by AT&T, GT&E, and USITA, and the Bureau staff.

The group should be charged with addressing implementation this year of remaining life rates for the embedded investment of all carriers; the implementation this year of Equal Life Group depreciation rates for the Outside Plant investment of all carriers, and in 1982, the implementation of ELG for Central Office Equipment. The group would determine a plan for the development of individual reserve accounts for AT&T companies so that their remaining life rates can be implemented. Finally, the group must address the resolution and implementation of the blanket filings for terminal equipment presently held by the carriers. These issues are of extreme urgency since technological and competitive changes allow very little time for recovery of the past deferred dollars of investment. The group must report its findings and recommendations to the Commission no later than December 1, 1981, in order for the Commission to adopt the necessary prescription orders prior to December 31, 1981.

The Cost Recovery Group should be constituted no later than September 1981, and should immediately establish deadlines for the carriers to present their proposals for implementation of Reserve Allocations, Remaining Life Rates, Equal Life Group rates and practices, and resolution of related problems. The Group should also immediately determine, announce, and adhere to a timetable for the accomplishment of these objectives.

I believe that this proposal will give the Commission the best opportunity to maintain the timetable for the implementation of capital recovery and thereby ensure the integrity of its competitive policies. I am recommending that this proposal be adopted by the full Commission.

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

CC Docket 79-105

In the Matter of

Amendment of Part 31, Uniform System of Accounts for Class A and Class B Telephone Companies, of the Commission's Rules and Regulations with respect to accounting for station connections, optional payment plan revenues and related capital costs, customer provided equipment and sale of terminal equipment.

PETITION FOR RECONSIDERATION

(Filed June 7, 1982)

Pursuant to Section 1.429 of the Commission's Rules, American Telephone and Telegraph Company, for itself and on behalf of the associated Bell System Operating Companies (hereinafter "Bell Companies"), respectfully requests that the Commission reconsider its *Memorandum Opinion and Order*, released April 27, 1982 (April 27 Order).[1]

I. *Preliminary Statement*

1. In its April 27 Order, the Commission found that, for intrastate ratemaking, states are *not* bound to follow rules prescribed by the Commission that require carriers to treat certain station connection costs as expenses rather than as a capital investment in plant. This action represents a withdrawal on the Commission's part of support for its cost causative ratemaking policy clearly enunciated in Docket 19129, Phase II (64 F.C.C. 2d 1 (1977)), and its *First Report and Order* herein (85 F.C.C.

[1] The Order was published in the Federal Register on May 5, 1982. 47 Fed. Reg. 19361 (1982).

2d 818 (1981) (First Report and Order)). In addition, the April 27 Order is based upon errors in fact and law.

2. In the short time since the April 27 Order was released, parties have already begun to interpret it broadly as meaning that the Commission no longer intends to support its national policies, particularly those promoting competition throughout the telecommunications industry, with the necessary depreciation (capital recovery) programs essential to the realization of such policies. However, for these competitive policies to be viable, carriers must be permitted and encouraged to recover their capital fully and in a timely fashion.

3. Even before the April 27 Order was adopted, the commissions of some states had stated that they did not intend to follow Commission prescribed depreciation.[2] More recently, the April 27 Order has been cited as relieving state commissions from any obligation to follow any depreciation method or rate prescribed by this Commission. Some parties have even cited the April 27 Order as indicating approval of state deviation from Commission-prescribed depreciation.[3]

4. The Bell Companies have been moving affirmatively in seeking timely Commission prescription of realistic depreciation rates. The use of those rates is central to the promotion of a broad range of Commission policies. Specifically, proper depreciation rates are essential to permit pricing decisions to be based on the true costs of service, thereby avoiding artificial barriers to compe-

[2] For example, General Orders adopted by the Alabama, Louisiana, and Nebraska Commissions each contained the following language: "Depreciation rates for . . . all . . . equipment historically regulated in the intrastate jurisdiction, will be set according to policies approved by this Commission. They will not be established to further a policy of 'deregulation' of the FCC." *Reaffirmation of the Applicability of State Regulatory Principles*, General Order, p. 3 (Neb. PSC, August 24, 1981); *Reaffirmation of the Applicability of State Regulatory Principles*, General Order, p. 4 (Ala. PSC, July 17, 1981); *Reaffirmation of the Applicability of State Regulatory Principles*, General Order, p. 4 (La. PSC, June 30, 1981).

[3] *See* Paras. 32-37. *infra*.

tition.[4] Moreover, adequate capital recovery will itself foster technological innovation which will directly enhance the efficiency of the communications network and will also expand the scope and extent of competitive alternatives.[5] In addition, the attainment of appropriate depreciation reserves will facilitate the timely implementation of the detariffing of customer premises equipment which the Commission has found necessary to accommodate changing technology and growing competitive markets.[6]

5. However, if state commissions are free to deviate from Commission prescribed depreciation for intrastate ratemaking and to deny the Companies the revenues needed to cover realistic depreciation, the beneficial effects of sound capital recovery will not be realized, thereby frustrating the Commission's policies. Thus, the Commission should find that, as a matter of policy under Sections 1 and 2 of the Communications Act of 1934 (Act),[7] states are bound to follow the Commission's prescription of depreciation practices and rates for intrastate ratemaking so as to avoid frustration of its policies. The Commission's nationwide policies must be accompanied by a uniform nationwide policy of capital recovery.

6. Moreover, the Commission, in promulgating expensing rules, was, in effect, prescribing classes of depreciable property and depreciation rates. As a matter of law, such action is preemptive on the States for all regulatory purposes by virtue of Section 220(b) of the Act.[8] For this reason alone, the Commission should reconsider its April 27 Order and find that states are required to follow the expensing rules for intrastate ratemaking.

7. Because there is an urgent need for the Commission to reaffirm the importance of capital recovery and exercise its statutory duty to preempt depreciation, both as a matter of law

[4] *See* Paras. 23-26. *infra.*

[5] *See* Paras. 20-22, *infra.*

[6] *See* Paras. 28-31, *infra.*

[7] 47 U.S.C. § 151-2.

[8] 47 U.S.C. § 220.

and as support for national policies, the Bell Companies believe that the Commission should give this Petition expedited consideration.

II. *Uniformly Applied Depreciation Is Essential To The Protection And Promotion Of Commission Policies*

8. The First report and Order in this proceeding, dated March 31, 1981, was a depreciation order and the expensing rules for station connections promulgated therein necessarily involve broader capital recovery issues.[9] For this reason, the preemptive effect of the First Report and Order, as clarified in the April 27 Order, must be reconsidered in light of the impact of depreciation matters generally on Commission policies.

9. As demonstrated below, Commission prescribed depreciation rates and methods play a central role in the effectuation of a broad range of Commission policies. The Commission should therefore take action to ensure that its prescribed depreciation, including the depreciation aspects of its expensing rules, is followed by all states.

A. *Timely And Effective Capital Recovery Is Essential To National Telecommunications Objectives.*

10. Telecommunications is a capital intensive industry. For example, the Bell System has invested about $2.00 in telephone plant for each $1,00 of annual revenues.[10] All carriers must

[9] In its First Report and Order, the Commission removed new inside wiring costs from the classes of depreciable property. It also adopted amortization rules for embedded inside wiring which amounted to a prescription of depreciation rates. These were actions taken under Section 220(b) of the Act, which provides for classifications of depreciable property and the prescription of depreciation rates.

[10] The Bell System is much more capital intensive than the average company, about four times as capital intensive as the fifty largest manufacturing companies, as measured by the investment to revenues ratio. The investment to revenues ratios of some of the Bell Companies' emerging competitors are: General Dynamics, 0.35; IBM, 0.75; ITT, 0.59; and Motorola, 0.52. (These data are for the 1980-81 period.)

recover their capital fully and in a timely fashion in order to remain viable providers of telecommunications services. The recovery of invested capital, therefore, is a fundamental part of carrying out the Commission's statutory responsibility to make available a rapid, efficient, nationwide communications service. The Commission has recognized its responsibility by providing recent changes to depreciation methods and rates.

11. The Commission has recognized that the use of appropriate depreciation is important to the financial viability of the carriers. It has stated that "distortion of the measure of depreciation would in turn lead to a misstatement of the results of operations for the period and would also misstate . . . its balance sheet. [S]uch distortions [could be] deemed to be deleterious to the safety and recovery of . . . investment, [and investors] would likely demand a higher return on their funds."[11]

12. The Commission has also found that its capital recovery reforms generally "will further the mandate of Section 1 of the Communications Act, 'to make available, so far as possible, to all people of the United States a rapid, efficient, Nation-wide, and world-wide wire and radio communications service with adequate facilities at reasonable charges. . . .' "[12]

13. However, depreciation only becomes capital recovery when it is fully and timely recovered through revenues authorized by the Commission and by state regulators. As recognized by the Financial Accounting Standards Board: "Unless an accounting order indicates the way a cost will be handled for rate-making purposes, it causes no enonomic effects . . . . The mere issuance of an accounting order not tied to rate treatment does not change an enterprise's economic resources or obligations."[13]

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[11] *Property Depreciation*, 83 F.C.C.2d 267, 272 (1980) (Docket 20188).

[12] *Id.* at 293, quoting 47 U.S.C. § 151.

[13] Financial Accounting Standards Board, *Accounting for the Effects of Regulation Of An Enterprise's Prices Based On Its Costs*, p. 21 (March 4, 1982) (exposure draft).

14. Jurisdictional separations assigns approximately 75% of depreciation expense resulting from Commission prescribed depreciation methods and rates to state regulatory jurisdictions. Unless intrastate rates are set to recover this 75% of depreciation expense, carriers will be denied the capital recovery determined by the Commission to be necessary and appropriate for a rapid, efficient nationwide communications service.

15. For these reasons, the establishment of depreciation methods and the prescription rates must be inseparable from ratemaking. The state commissions must use the depreciation rates prescribed by the Commission in determining intrastate revenue requirements. Otherwise, the impact of the spectrum of regulatory decisions bearing on national objectives—cost allocation, pricing, innovation and new technology, accurate representation of financial results, and internal funds generation—will be frustrated.

B. *The Commission Has Determined That Fostering Competition Is the Best Approach To Achieve Its Objectives*

16. In addition to adopting capital recovery reforms to further the mandate of Section 1 of the Act, the Commission has adopted a policy of promoting competition for telecommunications services as the means of carrying out the same statutory objective. It has repeatedly found that competition stimulates innovation thereby affording customers a wider range of services to meet their needs at lower cost.[14] The Commission has also found that competition results in "improved installation features including ease of making changes, competitive sources of supply, the option of leasing or owning equipment, and competitive pricing and payment options."[15] Thus, fostering competition has become the foundation of national telecommunications policy.

17. Competition and depreciation are inextricably tied together. Uniformly applied and properly determined depreciation

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[14] *Second Computer Inquiry*, 77 F.C.C.2d 384, 439 (1980); *see also*, *Competitive Carrier Rulemaking*, 85 F.C.C.2d 1, 14 (1980).

[15] *Second Computer Inquiry*, 77 F.C.C.2d at 439 (citations and footnotes omitted).

rates are essential to the Commission's policy of promoting competition. At the same time, the growth of competition dramatically changes depreciation requirements. Some of these interactive effects are discussed below.

1. *Impact Of Competition On Service Lives And Depreciation Methods*

18. The transition from a monopoly to a competitive environment has been one of the primary factors in changing service lives and, thus, the rates of capital consumption of communications plant. As competition increases, obsolesence becomes a more important factor in retirements, making service lives shorter than they were in a monopoly environment. Depreciation rates must be changed to reflect these shorter lives. Furthermore, because the Commission's policy of fostering competition was not anticipated in past depreciation rates, a change in depreciation methodology from whole life to remaining life is necessary.[16]

19. In light of these facts, the Commission has properly approved the use of more realistic service lives and remaining life depreciation. However, the Commission's actions will be ineffective unless state commissions follow Commission prescribed depreciation. The Commission, which has set that level of competition, must be responsible for setting the level of capital consumption to be recorded on the carrier's books and to be used for ratemaking purposes, both interstate and intrastate. It would be error for the Commission to leave the setting of depreciation rates used for ratemaking to state commissions which may disagree with federal policies and may wish to discourage their implementation or at least ignore their impact.

2. *The Promotion Of Innovation*

20. The Commission has stated that using equal life group depreciation (ELG) for prospective investments is necessary "[i]f the public is to realize the benefits of advances in communication" because ELG will encourage "innovation and . . . the

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[16] *Property Depreciation*, 83 F.C.C.2d at 290.

introduction of new technology."[17] The Commission further noted that the use of remaining life depreciation is just as necessary for embedded plant.[18] The same reasoning applies to the use of more realistic service lives reflecting the impact of current technology and competition.

21. Thus, the depreciation methods adopted by the Commission are key factors in encouraging innovation and the introduction of new technology. Innovation and technology, in turn, are key factors in fostering competition. As the Commission has noted, advances in large scale integrated circuitry and microprocessor technology have broadened the areas subject to competition and have opened up new, competitive markets.[19] Moreover, technology advances have reduced scale economies as a barrier to entry in many telecommunications fields.[20]

22. It can safely be said that the level of competition today could not exist without the technological developments of the last 15 years. If the Commission is to be successful in fostering competition in the future, it must insure that its prescribed depreciation will be followed in both inter- and intrastate ratemaking; otherwise the innovation necessary for continued competitive growth will be stifled.

3. *The Impact of Depreciation On Pricing*

23. Depreciation is also a principal ingredient underlying pricing decisions for carriers. The Commission has unequivocally recognized this fact:

> "Measures of costs under depreciation accounting . . . are of the utmost importance and should be as accurate as circumstances will allow. The accounting measures of costs and

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[17] *Id.* at 281.

[18] *Id.* at 290, 293-94.

[19] *See, e.g., Second Computer Inquiry*, 77 F.C.C.2d at 391 & 427.

[20] *See, e.g., id.* at 412.

revenues are the information base upon which pricing and ratemaking decisions are predicated."[21]

Pricing decisions in turn have a direct impact on the viability of competition. Firms in a competitive market, including regulated firms, must base their prices on costs.

24. It is not enough that pricing decisions are based on costs; the costs must be accurately stated. Rejection by state commissions of ELG depreciation, remaining life depreciation, and the use of more realistic service lives would misstate the costs of service used for pricing (ratemaking). It would understate the costs of services today by understating the current rate of capital consumption.[22] It would also overstate costs of services in the future, due to a growing base of underdepreciated plant. As a result, future customers would be required to subsidize current customers.[23] This intertemporal subsidy would send false price signals to the marketplace and would artifically inhibit competition.

25. Station connections provides a specific example of this concern. The Commission adopted its depreciation and accounting rules for inside wiring to further the "principle that the causative ratepayer should bear the full burden of the costs of station connections.[24] The Commission expressly stated that it wanted to avoid intertemporal subsidies for station connections.[25] Even though the Commission recognized that full cost causative pricing could not be assured with depreciation and accounting rules alone, it found that, without such rules, the embedded investment in inside wiring would continue to grow and there would be no way to avoid a continued shifting of costs caused by current customers to future customers. It therefore held that inside wiring should no longer be classified as depreciable property and that the depreciation methodology for the embedded investment in inside wiring should be based on a ten year amortization.

[21] *Property Depreciation*, 83 F.C.C.2d at 272.

[22] *See, e.g., Property Depreciation*, 83 F.C.C.2d at 293.

[23] *See, e.g., id.* at 268.

[24] *AT&T*, 64 F.C.C.2d 1, 55.

[25] *E.g., Deregulation of Inside Wiring*, 86 F.C.C.2d 885 (1981).

26. However, the only way to stop the placing of new inside wiring costs on future ratepayers is by state adherence to these depreciation related rules. Otherwise, if states are free to ignore the Commission's rules for inside wiring, its policy objectives will be frustrated because about 75% of inside wiring costs are assigned to intrastate operations.

4. *The Impact of Unrecovered Investment on Existing Carriers*

27. The Commission has recognized the need for existing carriers to be an intergral part of the growing competitive telecommunications markets on a continuing basis. Existing carriers are a vital link in the ongoing transition from a monopoly to a competitive environment. However, those carriers have made large investments in plant in line with past Commission policies. If the carriers are to make the transition to serving competitive markets, those investments must now be recovered in line with present Commission policies. Otherwise, the carriers' financial integrity will be impaired, ultimately raising costs of service and precluding the carriers' effective participation in an industry more and more characterized by free entry, lowered investment, and reduced capital carrying charges.

C. *The Full And Effective Implementation Of The Second Computer Inquiry Requires A Consistent Approach To Depreciation*

28. In the *Second Computer Inquiry* and related proceedings, the Commission has determined that detariffing customer premises equipment (CPE) and enhanced services is required to effect its pro-competitive policies[26] and that a full and timely implementation of detariffing will require some disposition of embedded

[26] *See, e.g., Second Computer Inquiry*, 77 F.C.C.2d at 427.

customer premises equipment.[27] Implementing detariffing will be difficult, although the use of sound depreciation will lessen those difficulties. For example, the Commission stated that "the remaining life rates [prescribed January 21, 1982] will . . . reduce the amount of any underdepreciation for 'embedded' CPE which may now exist and will facilitate the sale, transfer or other disposition of that CPE."[28]

29. Conversely, the failure of state commissions to use remaining life and other Commission prescribed depreciation will increase underdepreciation and interfere with the sale, transfer or other disposition of that CPE. The potential problem is substantial. The Commission has prescribed depreciation rates that increased annual depreciation expense for terminal equipment in the Bell System by about $800 million in 1981. Increased depreciation expense can be expected in the future. Thus, the rejection of Commission prescribed depreciation rates by even a few state commissions would result in a substantial reduction of capital recovery for the Bell Companies alone.[29]

30. This reduction of capital recovery would interfere with the disposition of assets contemplated under full implementation of the *Second Computer Inquiry*. When assets are disposed of by a common carrier, value is determined by netting the accumulated

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[27] *See, Procedures For Implementing The Detariffing Of Customer Premises Equipment And Enhanced Services (Second Computer Inquiry)*, Notice of Inquiry, CC Docket No. 81-893 (April 13, 1982).

[28] *Id.* Para. 5.

[29] Parties to state rate cases are urging state commissions to adopt depreciation rates lower than those prescribed by the FCC on the ground that capital recovery should not be a concern of the state commission since the assets, upon disposition, will be removed from state commission jurisdiction. *See, e.g., Pa. P.U.C. v. The Bell Telephone Co. of Pa.*, Testimony of Paul F. Levy, pp. 3-4, Pa. P.U.C. Dkt. R-811819 (filed April 9, 1982) (Economics and Technology witness) (hereinafter "Levy Testimony"); *id.*, Testimony of Jamshed K. Madan, pp. 9-10 (filed April 10, 1092) (Georgetown Consulting Group witness). The firms submitting this testimony participate in state rate cases throughout the country and frequently serve as state commission consultants.

depreciation against the gross original cost of the asset (*i.e.*, net book value).[30] The accumulated depreciation is the sum of annual depreciation charges. So long as state commissions use for intrastate ratemaking the Commission prescribed depreciation rates, book value is an undisputed amount. However, where the state commission uses a lower depreciation rate, the accumulated depreciation maintained to satisfy state commission requirements will be different from the accumulated depreciation recorded in the Uniform System of Accounts. The result is a disputed book value; the Commission prescribed value is less than the state commission value because the accumulated depreciation is greater. To complicate matters further, the portion of plant to which either book value could apply would shift over time with the changing allocation of plant to the interstate jurisdiction under the separations process.

31. State commissions and other parties can be expected to want to provide an input into any asset disposition process that may be instituted under the *Second Computer Inquiry*.[31] Without Commission preemption of depreciation, the resulting differences of opinion as to the book value of the transferred assets resulting from the use of non-uniform depreciation rates would complicate and delay the process.

III. *Preemption of the States with Regard to Depreciation is Necessary to Commission Policies*

32. As described above, state commission adherence to Commission prescribed depreciation in intrastate ratemaking is essential to avoid frustration of a broad range of Commission policies. It is not enough to assume that state commissions will go along with Commission prescribed depreciation without direction from

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[30] Adjusted net book value would include tax and other impacts to reflect the net regulated value of the asset.

[31] The suggestion is being made before state commissions that the capital consumption accounted for by them in setting intrastate rates should be controlling in that process. *See, e.g.*, Levy Testimony, *supra*, at pp. 3-4, 24-26.

the Commission. Although it is true that state commissions have followed Commission depreciation in the past almost without exception, the current changes in the industry and the implications for capital recovery are more severe than at any time since the Commission was established. Therefore, history cannot be a guide to the future.

33. There are clear signs that a substantial number of states will now deviate from Commission prescribed depreciation. In the first place, a number of state commissions disagree with this Commission's pro-competitive policy. Already, three state commissions have stated they intend to deviate from Commission prescribed depreciation rates expressly so as to interfere with the implementation of this Commission's pro-competitive policies, with which they disagree.[32] A number of other state commissions have denied the use of remaining life or ELG depreciation without being so specific as to their reasons.[33]

34. Futhermore, some state commissions, while not necessarily disagreeing with Commission policies, may feel that specific depreciation methods, necessary to promote those policies, are not consistent with their regulatory views. For example, the Ohio Commission recently rejected the use of remaining life depreciation on the ground that it was contrary to that Commission's regulatory policies under Ohio law.[34]

35. Finally, in the short time since it was issued, the Commission's April 27 Order itself is already being broadly interpreted by various parties as relieving state commissions from any obligation to follow any depreciation method or rate prescribed by the Commission. Some parties have even cited the April 27 order as

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[32] *See* p. 2, n.2, *supra*.

[33] *See, e.g., Application of Mountain States Tel. & Tel. Co.*, Idaho P.U.C. Case No. U-1000-55 (March 1, 1982); *Southern Bell Tel. & Tel. Co.*, S.C. P.S.C. Dkt. No. 81-201-C (Jan. 8, 1982).

[34] *Ohio Bell Telephone Co.*, Case No. 80-1010-TP-AAM, pp. 29-31 (Ohio PSC, April 21, 1982). The Ohio Commission did not decide the preemption question, finding that it did not have the authority to do so under Ohio law. *Id*, at 28-29.

indicating approval of state deviation from Commission-prescribed depreciation.

36. For example, the New Jersey Division of Rate Counsel recently submitted testimony recommending rejection of remaining life depreciation and citing the Commission's decision in its April 27 Order for the proposition "that the FCC will accept the disallowance."[35] At oral argument in a proceeding before the Michigan Public Service Commission, Staff Counsel referred to the April 27 Order in support of his assertion that this Commission had no jurisdiction to determine the depreciation rates and methods used for intrastate ratemaking.[36] At the recent three-way represcription meeting for New England Telephone, one of the state commission staff members, referring to the decision in the April 27 Order, stated that the depreciation rates to be used for ratemaking purposes would be determined by the state commissions irrespective of the findings of this Commission.

37. Thus, the Commission must preempt the states in depreciation matters to ensure that its prescribed depreciation will be followed by the states, as is necessary for the furtherance of Commission policies. As demonstrated below, the Commission has the legal authority to so preempt the states and the obligation to exercise that authority.

IV. *The Commission Has The Authority And The Obligation To Preempt The States As To Depreciation*

38. Because preemption of depreciation matters is essential to the Commission's policies, the Commission has the authority and duty under both Section 2 and Section 220(b) of the Communications Act to preempt the states as to depreciation generally and specifically as to the classification and depreciation of station

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[35] *Application of New Jersey Bell Telephone Company*, Testimony of Charles W. King, p. 5, N.J. BPU Docket No. 815-458 (filed April 1982).

[36] *Review of Michigan Bell Telephone Company For Revision of its Depreciation Rates*, Tr. 28, Mich. PSC Case No. U-6388 (May 14, 1982 Oral Argument).

connections. The Commission should make preemption clear to all parties.

A. *The Commission's Power To Preempt Under Section 2 Is Applicable In This Case.*

39. The Commission found in its April 27 Order that the Communications Act, and specifically Section 2(b), "does not prohibit preemption of state regulatory actions that might interfere with or tend to frustrate policies or rules [the Commission has] adopted to carry out statutory objectives with respect to interstate and foreign communications."[37] The courts have stated the limitations of Section 2(b) even more strongly.

40. For example, the Fourth Circuit has held that Section 2(b) applies only to facilities "separable from and . . . not substantially affect[ing] the conduct or development of interstate communications."[38] The Commission has jurisdiction under Section 2(a) over all other plant. The District of Columbia Circuit has cited the Fourth Circuit decision with approval, declaring that "the Commission . . . may regulate facilities used in both inter- and intra-state communications" to the extent the unified regulation is needed.[39]

41. Moreover, where there may be interference with or a tendency to frustrate Commission rules and policies adopted to carry out its statutory objectives, preemption of state action is necessarily implied. The Supreme Court has held that this Commission has jurisdiction "not merely to protect but to promote [its

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[37] April 27 Order, Para. 37.

[38] *North Carolina Utilities Commission v. FCC*, 552 F.2d 1036, 1046 (4th Cir.) *cert deneid* 434 U.S. 874 (1977) (hereinafter NCUC II) quoting *North Carolina Utilities Commission v. FCC*, 537 F.2d 787, 793 (4th Cir.) *cert deneid* 429 U.S. 1027 (1976).

[39] *California v. FCC*, 567 F.2d 84, 86 (1977), *cert. denied*, 434 U.S. 1010 (1978). In even stronger language, Judge Wright has stated that: "To the extent the . . . services . . . involve or may involve interstate communications, Section [2(b)] is clearly inapplicable." *National Association of Regulatory Utility Commissioners v. FCC*, 533 F.2d 601, 634 (D.C. 1976) (Wright, J., dissenting).

statutory] objectives."[40] And it has been expressly held that "FCC regulation *must preempt* any contrary state regulations where the efficiency or safety of the national communications network is at stake."[41]

42. Because of the central role that depreciation, including the depreciation aspects of expensing station connections, plays in the effectuation of Commission policies, preemption is necessary to avoid interference with or frustration of commission policies. To hold otherwise would require reversal of the Commission's findings in Docket 20188, the First Report and Order in Docket 79-105, and the Second Computer Inquiry. Thus, the Commission must find that its prescription of depreciation methods and rates preempts the states.

B. *The Commission Erred In Its Order By Not Preempting Under Section 220(b)*

43. In addition to the reasons for preemption set forth in Paragraphs 39-42 *supra*, the Commission should reconsider its April 27 Order because of the specific errors of law and fact in the April 27 Order which, in themselves, are grounds for reconsideration.

1. *The Commission Has Erred By Ignoring The Provisions Of Section 220(b)*

44. The Commission in its April 27 Order, Part II,[42] assumes, that "AT&T . . . relies primarily upon Subsection 220(g) . . . ." To the contrary, the crux of this case is that the Commission, by adopting rules for the expensing station connections in the First Report and Order, acted pursuant to Section 220(b) of the Act by which Congress granted it exclusive power to prescribe classes of depreciable property and depreciation rates.

45. While the Commission has the statutory flexibility under Section 220(g) to permit deviations from its *accounting* rules,

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[40] *United States v. Midwest Video Corp.*, 406 U.S. 649, 667 (1972).

[41] *NCUC II*, 552 F.2d at 1046 (emphasis added).

[42] April 27 Order, Paras. 9-37.

there is no statutory provision which permits any deviation from classification of depreciable property and prescription of *depreciation* under Section 220(b). Because the Commission's First Report and Order classified property and prescribed depreciation rates under Section 220(b), carriers and state commissions are obliged to follow these rules for intrastate ratemaking.

46. Section 220 permits flexibility in respect of accounting rules promulgated by the Commission. Section 220(a) of the Act provides that "[t]he Commission may, *in its discretion*, prescribe the forms of any and all accounts, records, and memoranda," as distinguished from the mandatory requirements of Section 220(b). Once the Commission prescribes accounting rules, carriers must maintain their regulatory books of accounts in accordance with such rules pursuant to Section 220(g) of the Act, which states in pertinent part: "it shall be unlawful for [any carrier] to keep any other accounts, records, or memoranda than those so prescribed *or such as may be approved by the Commission*" (emphasis added).

47. Section 220(g) thus permits carriers to keep accounts other than those prescribed by the Commission if they are "such as may be approved by the Commission." The Commission in fact has approved variations from its prescribed Uniform System of Accounts. For example, Section 31.01-2(f) of its Rules gives states "blanket" authority to subdivide prescribed accounts for this purpose.[43] Another variation cited in the Commission's Order deals with plant under construction (April 27 Order, Para. 32). There, the Commission expressly approved state commission ratemaking treatment of plant under construction different from that adopted by the Commission. The necessary implication of

[43] *See* April 27 Order, Para. 18, n.10. The Commission's reliance on this provision is misplaced in this case. That provision allows states only to subdivide primary accounts (*e.g.*, to subdivide a capital account like central office equipment into various categories of capitalized central office equipment). It does not mean that where the USOA requires a transaction to be expensed, a state can require the carrier to capitalize that same transaction. This would be the result if a state required a carrier to capitalize a station connection cost for which the Commission requires expensing.

this action is that the accounts, records, and memoranda required to implement a different ratemaking treatment for that plant would be "such as may be approved by the Commission" and would therefore be permissible under Section 220(g). These examples illustrate the flexibility provided by Section 220(g).[44] They do not support the Commission's mistaken finding that Section 220 has no binding effect on the states whatsoever. For, as shown below, Section 220(b) requires adherence to Commission prescribed depreciation rates.

2. *The Provisions of Section 220(b) Mandate Preemption*

48. Section 220(b) of the Communications Act grants the Commission *exclusive* power to prescribe depreciable classes of property and depreciation rates of carriers under its jurisdiction. It provides:

> (b) The Commission *shall*, as soon as practicable, *prescribe* for such carriers the classes of property for which depreciation charges may be properly included under operating expenses, and the percentages of depreciation which *shall* be charged with respect to each of such classes of property, classifying the carriers as it may deem proper for this purpose. The Commission may, when it deems necessary, modify the classes and percentages so prescribed. Such carriers *shall not*, after the Commission has prescribed the classes of property for which depreciation charges may be included, charge to operating expenses any depreciation charges on classes of property other than those prescribed by the Commission, or, after the Commission has prescribed percentages of depreciation, charge with respect to *any* class of property a percentage of depreciation *other than* that prescribed therefor by the Commission. No such carrier shall *in any case* include in any form under its operating or other

[44] The Commission cited these examples as illustrating "forty years of administrative practice" which would be repudiated by preemption. (April 27 Order, Para. 34.) However, since these practices would still be permissable under Section 220(g), they would not be repudiated. Moreover, no administrative practice can change the Commission's statutorily imposed obligations under the law.

expenses *any* depreciation or other charge or expenditure included elsewhere as a depreciation charge or otherwise under its operating or other expenses. (emphasis added)

49. In the plain language of Section 220(b), the Commission has preemptive regulatory authority over matters of depreciation. The language Congress chose was express and unequivocal: that the Commission "shall . . . prescribe" for carriers subject to its jurisdiction "classes of property for which depreciation charges may be properly included under operating expenses," and the "percentages of depreciation which shall be charged to . . . such classes."

50. Moreover, after Commission prescription, such carriers "shall not" charge any depreciation on "classes of property" not classified by the Commission as depreciable, and the carriers shall not charge in any case "a percentage of depreciation" "other than that prescribed by the Commission."[45]

51. Thus, Section 220(b) requires that depreciation prescribed by the Commission is binding for all purposes. In its First Report and Order, the Commission acted under Section 220(b) and thereby bound the states.

3. *The Legislative History of Section 220(b) Supports Mandatory Preemption*

52. The Commission has erred in apparently concluding that depreciation it prescribes pursuant to Section 220(b) is not binding on states for intrastate ratemaking.[46] The Commission's

[45] It is fundamental to statutory construction that where the statutory "language is clear and unambiguous it must be held to mean what it plainly expresses." Sutherland, *Statutory Construction*, Section 46.01, Fourth Edition, 1973. Also, see Association of American Railroads v. Costle, 562 F.2d 1310 (D.C. Cir. 1977), which holds that "[t]he word 'shall' is the language of command in a statute. . . ." (at p. 1312).

[46] "Apparently" is used here in the sense that while the thrust of the Order is directed at Sections 220(a) and 220(g) of the Act, the Commission appears to sweep into its conclusion that matters of depreciation prescribed under Section 220(b) are likewise not binding on the states.

apparent conclusion is in part premised upon a misreading of the legislative history of Section 220.

53. The Interstate Commerce Commission (ICC), acting under the Section 20(5) of the ICC Act, which was recodified in the Communications Act as Section 220(b), correctly interpreted its powers regarding depreciation as plenary. In *Depreciation Charges of Telephone Companies*, the ICC rejected the view that Section 20(5) could not properly apply to plant jointly used for inter- and intrastate service.[47]

> "It seems to be well established that where a local telephone company undertakes to originate or deliver toll messages, and most of them do so undertake, practically all of its property is open for use in interstate commerce and at any time may be so used. Under such circumstances, no doubt would seem to exist as to the power of Congress to regulate the accounting practices of such companies with respect to their property, including the accounting for depreciation."[48]

54. Therefore, it is not surprising that when Congress was considering the Communications Act of 1934, the states promoted the original version of Section 220. That version, in Section 220(j), would have expressly permitted state commissions to prescribe depreciation rates for purposes of exercising their jurisdiction over telephone companies, but Congress ultimately dropped this provision in favor of merely having the Commission report on the desirability of further legislation in this area. During hearings on the bill in each House of Congress, state commissions, through the National Association of Railroad and Utility Commissioners ("NARUC"), vigorously argued that such an express provision was necessary for states not to be bound in intrastate rate cases by Commission prescribed depreciation rates.

55. Notwithstanding the evidence to the contrary, the Commission erroneously concludes in its April 27 Order that the legislative history of the Communications Act does not indicate

[47] Virtually all of the Bell Companies' plant is so used.

[48] *Depreciation Charges of Telephone Companies*, 118 I.C.C. 295, 332 (1926).

an intent on Congress' part to give the Commission preemptive authority over depreciation.

56. The Commission relies heavily on the statements made by witnesses at legislative hearings to support its contention that the original language of Section 220(j), which would have expressly precluded preemption, was proposed only to clarify prior law.[49] However, the Commission ignores the language incorporated into the various committee reports, namely: (1) the statement in the House Report that the original Section 220(j) language was "responsive to the requests of State commissions *that the present law be changed so as to permit* those bodies to exercise, for State purposes, certain jurisdiction over . . . depreciation";[50] and (2) the statement in the Senate Report that the Senate version of Section 220(j), similar to that enacted, "calls for investigation and report to Congress *instead of* immediately turning over these matters to the State."[51]

57. Moreover, the Commission mischaracterizes the testimony of the witnesses, stating: "Only one opposing witness [Mr. Gifford], however, specifically expressed the view that the then-current law [reenacted in Section 220(a)-(g)] prohibited the states from prescribing accounts and depreciation rates. . . ."[52] To the contrary, Mr. Benton, NARUC's general solicitor, testified in the Senate hearings:

> "Ever since Congress in 1920 empowered the Interstate Commerce Commission to prescribe rates of depreciation, the State commissions have believed it would work to their embarrassment and do the public injury. . . . They think it is a dangerous thing to have a Federal commission . . . fixing rates of depreciation. . . . It is dangerous, because if they are

[49] April 27 Order, Paras. 21-29.

[50] H.R. Rep. No. 1850, 73rd Cong., 2d Sess. 6 (1934) (emphasis added).

[51] S. Rep. No. 781, 73rd Cong., 2d Sess. 5 (1934). (emphasis added).

[52] April 27 Order, Para. 26.

> fixed wrong, then . . . the State commission's hands are tied."[53]

The report of the Interstate Commerce Commission to the Senate Committee on Interstate Commerce stated:

> "Paragraph (j) . . . directly conflicts with . . . uniform depreciation accounting required by the preceding provisions of the section. *That is not true under present law.*"[54]

And, Dr. Irwin Stewart, Department of State, testified that Section 220(b) was "taken from the Interestate Commerce Act which [gave] to the Interstate Commerce Commission the right to . . . fix depreciation charges. . . . That is, *it takes away jurisdiction that the State may have had.*"[55]

58. By misinterpreting the ICC rulings under Section 20(5) of the ICC Act and by ignoring relevant parts of the legislative history, the Commission has erred in concluding that Section 220 of the Act does not preempt the states with respect to depreciation. Indeed, the Commission cannot lawfully permit states to deviate from its prescription of depreciation matters under Section 220(b) of the Act.

Conclusion

For the foregoing reasons, the Bell Companies request that the Commission reconsider its April 27 Order and find that, in accordance with Section 220(b), states are bound, for all regulatory purposes, to follow Commission orders prescribing depreciation classifications, methods, and rates and to follow its First Report and Order as it pertains to expensing station connection costs specifically, and to depreciation matters generally. In the alternative, the Bell Companies request that the Commission, in

[53] Hearings on S. 2910 Before Committee on Interstate Commerce, 73rd Cong., 2d Sess., p. 181 (1934) (Benton statement).

[54] *Id.* at 208 (emphasis added).

[55] Hearings on H.R. 8301 Before Committee on Interstate and Foreign Commerce, 73rd Cong., 2d Sess., p. 17 (1934) (statement of Irwin Stewart) (emphasis added).

accordance with its powers under Sections 1 and 2 of that Act, preempt depreciation matters for all intrastate regulatory purposes so as to avoid interference with or frustration of its policies.

Respectfully submitted,

AMERICAN TELEPHONE
AND TELEGRAPH COMPANY

By /S/
Raymond F. Scully

By /S/
Lester G. Stiel

By /S/
W. Preston Granbery

Its Attorneys

195 Broadway
New York, New York 10007

Before the
FEDERAL COMMUNICATIONS COMMISSION
WASHINGTON, D.C. 20554

FILE NO.:
DOCKET NO.:

IN THE MATTER OF:

PETITION FOR DECLARATORY RULING ON QUESTION OF FEDERAL PREEMPTION INVOLVING ORDER OF THE PUBLIC UTILITIES COMMISSION OF OHIO IN CONFLICT WITH (I) FCC PRESCRIPTIONS UNDER SECTION 220 OF THE COMMUNICATIONS ACT AND (II) ESTABLISHED FCC POLICIES.

TO THE COMMISSION.

PETITION FOR DECLARATORY RULING
[Filed June 7, 1982]

General Telephone Company of Ohio ("General"), pursuant to Section 1.2 of the Commission's Rules, 47 CFR Section 1.2, and Section 5(e) of the Administrative Procedure Act, 5 U.S.C. 554(e), submits the following Petition for Declaratory Ruling:[1]

I. PARTIES

1. General is an Ohio corporation and a telephone company having its principal place of business at 100 Executive Drive, Marion, Ohio 43302. General provides telephone service in Ohio and Michigan, and is fully subject to the Communications Act of 1934 ("the Act"), 47 U.S.C. Section 151 et seq.

2. The Public Utilities Commission of Ohio ("PUCO") is the duly constituted state agency having jurisdiction with respect to the intrastate rates, charges, practices, and procedures of

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[1] General is also filing, as one of the GTE telephone companies, a petition in response to the Commission's Memorandum and Order released April 27, 1982, in CC Docket 79-105.

General. The offices of the PUCO are located at 375 South High Street, Columbus, Ohio 43215.

II. BACKGROUND

3. In accordance with this Commission's triennial depreciation represcription process, General was scheduled for review in 1981. On January 28, 1982, pursuant to § 220(b) of the Act, this Commission released its Order (FCC 82-40) prescribing revised percentages of depreciation for General, as well as other GTE companies. Depreciation accrual rates utilizing remaining life methodology, approved in Docket No. 20188,[2] were prescribed for all of General's plant accounts, effective December 1, 1981, except Account No. 232 which is effective October 1, 1981. Objections by the PUCO to the use of remaining life methodology and to the effective date were considered by this Commission and rejected.

4. On February 3, 1982, this Commission released its Order (FCC 82-53) modifying certain rates prescribed in its earlier Order so as to prescribe revised percentages of depreciation in accordance with the equal life group (ELG) methodology approved in Docket No. 20188. The ELG depreciation rates were prescribed effective January 1, 1982, applicable to future additions to outside plant for General and three other GTE telephone companies.

5. On April 26, 1982, the PUCO issued its Opinion and Order in Case Nos. 81-383-TP-AIR, 80-1124-TP-AAM and 81-354-TP-AAM, involving General's application to increase intrastate rates and charges and to change its depreciation accrual rates. The PUCO determined that it would not use the remaining life and/or the ELG depreciation rates prescribed by this Commission in determining the proper allowance for depreciation expense in General's rate case. The PUCO considered the merits of whole life and remaining life methodologies, and rejected the use of remaining life methodology and depreciation accrual rates. The PUCO prescribed new depreciation accrual rates based on the

[2] 83 FCC 2d 267 (1980); *Reconsideration*, 87 FCC 2d 916 (1981)

whole life method, and ordered that General apply the new whole life depreciation accrual rates to its intrastate plant commencing May 1, 1982, until the PUCO orders otherwise. Attached hereto as Exhibit A are pages 23-27 and 60 of the PUCO's Opinion and Order, involving the depreciation issues determined therein.

6. The April 26, 1982 Order of the PUCO prescribing whole life depreciation rates for General is in conflict with Orders of this Commission released January 28, 1982 (FCC 82-40) and February 3, 1982 (FCC 82-53). Attached hereto as Exhibit B is the schedule of remaining life depreciation accrual rates prescribed by this Commission for General. Attached hereto as Exhibit C is the schedule of equal life group depreciation accrual rates prescribed by this Commission for General. Attached hereto as Exhibit D is the schedule of whole life depreciation rates prescribed by the PUCO for General. The PUCO prescribed depreciation accrual rates are generally lower than the depreciation accrual rates prescribed by this Commission. Use of the remaining life and ELG depreciation accrual rates prescribed by this Commission would have resulted in approximately $7 million more depreciation expense and capital recovery in General's rate case than resulted from the use of the PUCO's whole life depreciation accrual rates.

III. THIS COMMISSION HAS ALREADY REJECTED THE PUCO'S POSITION AGAINST REMAINING LIFE METHODOLOGY

7. The PUCO participated in this Commission's three-way meeting procedure with respect to the prescription of depreciation rates for General. In addition, as shown by Appendices 1 and 2 to this Commission's Order released January 28, 1982, (FCC 82-40), the PUCO further emphasized its opposition to remaining life methodology in its comments in response to the public notices issued January 27, 1981, and October 30, 1981. The PUCO further strongly objected to the company's requested effective date of December 1, 1981. These objections were considered by this Commission in paragraphs 35 through 42 of its Order released January 28, 1982, (FCC 82-40), and were rejected.

8. In addition, in its Order released February 3, 1982 (FCC 82-53), the Commission rejected contentions by the Michigan and Florida Public Service Commissions that companies in those states may not implement ELG until the State Commission issues a further Order permitting the use of that methodology. This Commission stated:

> "We have allowed, even encouraged, the use of ELG in Docket No. 20188 and are prescribing ELG rates in this proceeding. No further action is necessary for General of Michigan or General of Florida to put ELG rates into effect, and, indeed they are bound to follow our prescription."[3]

IV. THE PUCO ORDER FRUSTRATES FCC POLICIES

9. By using lower depreciation accrual rates for intrastate ratemaking purposes than prescribed by this Commission, the PUCO frustrates important capital recovery objectives of this Commission. In Docket No. 20188 this Commission found that ELG will further the mandate of Section 1 of the Communications Act. The Commission recognized that ELG "is likely to result in an increase in the near term in revenue requirements" but stated its belief "that the relative size of the increment will be repaid many times over in future years as the ability of regulated telephone companies to continue to provide '... rapid, efficient ... communication service with adequate facilities at reasonable charges is enhanced.'" See 83 FCC 2d at 281. The PUCO Order provides for less depreciation expense and less capital recovery than determined necessary by this Commission.

10. This Commission has recognized that every method of depreciation is predicated upon estimates of prospective events, and there can be no assurance that these estimates will accord perfectly with actual events as they unfold years later. The

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[3] The Commission noted in footnote 2 that it did not decide the effect of prescribing those rates for intrastate ratemaking purposes, and that the question was under review in Docket CC 79-105. A petition addressed to the Commission's April 27, 1982 Memorandum and Order therein is being filed by the GTE telephone companies. See Note 1.

Commission determined that: "Equal life group adjustments will be handled by application of remaining-life adjustments in the setting of rates during the normal represcription process." See 83 FCC 2d at 286, paragraph 66. As noted in Docket 20188:

> "With respect to telecommunications investment, the impact of new technology and the transition from a monopoly to a competitive environment have led to an overall shortening of life estimates. If the currently estimated shorter lives had been known all along, then past depreciation rates would have been higher even under the timing pattern of SLVG, and current reserves would be higher. Absent a reversal of current trends and without corrective action, the amount of difference due to errors of life estimate will continue to grow, and upon ultimate retirement the reserve provisions will not be adequate. It is for this reason that the Commission makes the choice that it must regarding the charging of costs to current and future periods." 83 FCC 2d at 290.

The Commission then directed all subject carriers to maintain book reserves in sufficient detail to allow the determination of depreciation rates by the remaining-life technique, and stated: "It is our desire that these actions not be delayed and that the corrective measures of remaining-life rates be implemented as soon as practicable. 83 FCC 2d at 290. These important objectives of this Commission are directly challenged and frustrated by the PUCO's Order.

11. The use of different depreciation rates for the interstate portion of General's plant accounts than for the intrastate portion will not achieve one hundred percent capital recovery, except by sheer and remote chance, even if the "books" for each jurisdiction reflect full capital recovery. The reason for this is that jurisdictional allocation factors are continually changing. Attached hereto as Exhibit E is an analysis illustrating this fact. Moreover, in this situation there continues to exist a possibility of "stranded investment"—i.e., a residue of investment dollars remaining in rate base long after retirement of the related asset. In fact. "stranded investment" may remain in rate base in perpetuity if a remaining life adjustment is never made. In Docket No. 20188 this Com-

mission sought to avoid "stranded investment." See 83 FCC 2d at 288, 289.

12. Further, the use of different depreciation rates for ratemaking purposes as opposed to depreciation rates for book purposes or depreciation rates for financial reporting purposes, creates confusion and casts doubt upon the financial integrity of the company's books and records. The determination of the company's revenue requirement, and necessary rates, must be made on a basis consistent with the books and records of the company if the books and records are to present a true financial picture of the firm. This Commission emphasized this point in Docket 20188:

> "If depreciation policies or practices were to be determined solely with concern for the level of revenue requirements, the actual measure of depreciation might be misstated. Such distortion of the measure of depreciation would in turn lead to a misstatement of the results of operations for the period and would also misstate the relative position of the enterprise as shown by its balance sheet. If such distortions were perceived by present and potential investors and were deemed to be deleterious to the safety and recovery of their investment, they in turn would likely demand a higher return on their funds. Consequently, a failure to properly measure by understating these costs would, in the long run, probably be offset by higher costs of capital without any real avoidance of the ultimate need to provide full recovery for the capital." 83 FCC 2d at 272.

13. At the same time, the Commission made clear that its concern in Docket 20188 was not merely with reporting requirements, but with the underlying process of capital recovery. When numerous state commissions strenuously objected to industry proposals for FCC adoption of ELG on the ground that such action by the FCC would result in dramatic increases in intrastate rates, the Commission gave explicit consideration to this question, and rejected the arguments of the states with the following comments:

> "We do not find increased rates (for subscribers) inconsistent, *per se*, with our mandate under Section 1 of the Act. . . . We must balance the interests of all present and all future customers in the preservation of adequate facilities at reasonable charges. On balance, we find it not unreasonable that present ratepayers incur some additional expense in order to preserve the integrity of the investment and to assure the continued and longer term satisfaction of the requirements of our congressional mandate. The only alternative, continued deferral of both recognition of current costs and initiation of corrective measures to rectify any past unrecovered costs, will require much larger adjustments to be made at some future date." 83 FCC 2d at 293.

14. In Docket 20188, after seven years of study, the FCC established definite policies regarding depreciation, and depreciation-related matters, by a unanimous vote of the Commissioners. With respect to these questions, the Docket 20188 decision establishes the "statutory objectives", the "federal policies or rules", and the "important interests of national communication policy" as these phrases are used in paragraph 37 of the Commission's decision released April 27, 1982, in CC Docket 79-105, FCC 82-155. Under the principles there set forth, any state action, including "state ratemaking actions", must be reconcilable with the foregoing.

15. If state regulation is permitted to frustrate the Commission's "important interests of national communications policy" as to capital recovery, such action also will serve to frustrate the Commission's "important interests" as to deregulation. The one cannot be separarted from the other. In relation to CPE deregulation, the Commission has recognized this fact in Docket 20828:

> "[D]etariffing of CPE requires consideration not only of transition procedures, but also of separations implications, ***depreciation rates, investment recovery,*** asset valuation and transfer pricing." (84 FCC 2d at 68, emphasis added.)

16. Indeed, these are the very issues which delayed the Commission's originally intended deregulation date of March 1,

1982 for embedded CPE, and which required further consideration in a separate implementation proceeding, CC Docket 81-893:

> "In the implementation proceeding which we will initiate shortly, we will address issues of *capital recovery*[15] and asset valuation, alternative mechanisms by which transition to an unregulated CPE environment may be achieved, and the appropriate time period for removal of embedded CPE investment from separations and a carrier's rate base." (84 FCC 2d at 69, emphasis added.)

17. Further, in Footnote 15 to the language just quoted, the Commission stressed the interrelationship of the Commission's capital recovery policies and the Commission's CPE deregulation policies.

> "Represcription of depreciation rates for terminal equipment is expect to proceed on a parallel course, utilizing the existing processes. *We believe this course to be desirable because of the need to closely coordinate our represcription of depreciation rates for jointly-used plant with affected state commissions.* See 47 U.S.C. Sec. 220(i)." (84 FCC 2d at 69, emphasis added.)

18. The same linkage exists between the Commission's capital recovery policies and its competitive policies. This linkage is integral to the Commission's ability to carry forward its competitive policies for network services as well. For example, one of the significant issues in introducing competition in intercity telecommunications services is the possibility of intercity carrier bypass of local telephone exchange facilities, and the impact such bypass might have on the availability of exchange access revenues and revenue requirements for local exchange telephone services. Unless the Commission's capital recovery policies, established in Docket 20188, are given real effect in terms of actual capital recovery, the rate base in jointly-used network access plant, and its attendant carrying costs, will be significantly inflated, thereby imposing burdens on exchange access charges for all carriers and encouraging local network bypass by intercity carriers to the detriment of local exchange ratepayers.

19. The direct conflict between the PUCO's Order and the FCC's decision to issue prescriptions for General—overriding State Commission objections to remaining life and ELG—establishes the need for decisive action by this Commission asserting its power and responsibility under Section 220(b) of the Act to foreclose inconsistent state action.

V. THIS COMMISSION HAS THE AUTHORITY AND RESPONSIBILITY TO PREEMPT THE PUCO'S USE OF DEPRECIATION RATES OTHER THAN THOSE PRESCRIBED BY THIS COMMISSION

20. Under principles of constitutional law, there is unquestioned federal power under the Commerce Clause of the U. S. Constitution to regulate an activity which has a "substantial economic effect" upon interstate commerce. See *Rasmussen v. American Dairy Assoc.*, 472 F. 2d 517 (9th Cir. 1973), *cert. denied* 412 U. S. 950 (1973); *Katzenbach v. McClung*, 379 U. S. 294, 301-305 (1964); *Maryland v. Wirtz*, 392 U. S. 183[,] 196-197 (1968); and *Wickard v. Filburn*, 317 U. S. 111, 125-128 (1942). Congress, in the Communications Act, and the courts, in cases discussed below, have recognized the substantial economic effect of telephone service on interstate commerce.

21. Further, where there is a proper exercise of federal power, inconsistent state action will be preempted. The law does not permit state action which would constitute "an obstacle to the accomplishment and execution of the full purposes and objectives of Congress." See *Hines v. Davidowitz*, 312 U. S. 52, 67 (1941); De Cana v. Bica, 424 U. S. 351, 363 (1976); *Florida Lime & Avocado Growers Inc. v. Paul*, 373 U. S. 132, 142 (1963).

22. It is established law that the jurisdictional provisions of the Act (47 U.S.C. §§151, 152 and 221(b) do not deprive the Commission of jurisdiction over the use of facilities that necessarily serve both interstate and intrastate communications. In fact, FCC jurisdiction is to be precluded *only* in the case of:

> "local services, facilities and disputes that in their nature and effect are *separable from and do not substantially affect the*

conduct or *development* of interstate communications." (Emphasis added.)

North Carolina Util. Comm'n v. FCC, 537 F. 2d 787, 793-794 (4th Cir. 1976), *cert. denied* 429 U. S. 1027 (1976) *(North Carolina I)*.

The Fourth Circuit provided further clarification in *North Carolina Util. Comm'n v. FCC*, 552 F. 2d 1036, 1044-1050 (4th Cir. 1977), *cert. denied* 434 U. S. 874 (1977) (North Carolina II), where the *North Carolina I* principles were approved and expanded:

> "*North Carolina I* correctly reasoned that if section 2(b) (1) [47 U.S.C. § 152(b) (1)] were construed to give the states primary authority over joint terminal equipment, *i.e.* equipment used interchangeably for interstate and intrastate service, then—whenever state regulations conflicted with federal rules applicable to interstate calls—the FCC would necessarily be prevented from discharging its statutory duty under sections 1 and 2(a) [47 U.S.C. § 151 and § 152] to regulate interstate communication."
>
> 552 F. 2d at 1045.

23. Commenting that there "can be no doubt that, when the Communications Act was passed, Congress envisioned circumstances in which the same equipment would be employed for both interstate and local communication" (at 1046), the Fourth Circuit disposed of the argument that FCC jurisdiction is limited to equipment used predominantly for interstate purposes:

> "The question is whether jointly used facilities are to be classified for jurisdictional purposes as the 'interstate facilities of sections 1, 2(a) and 3(a), or as the 'intrastate' facilities of section 2(b) (1). Sections 1, 2(a) and 3(a) [47 U.S.C. §§ 151, 152(a) and 153(a)] commit jurisdiction over facilities utilized in interstate communication to the FCC. Section 2(b) (1) [47 U.S.C. § 152 (b) (1)] does not deny the FCC jurisdiction with respect to *interstate* facilities: it excludes only *intrastate* facilities from FCC jurisdiction. The terminal equipment dealt with in the order appealed from is used for *both* interstate and intrastate communication. *The withdrawal of jurisdiction over one cannot be read to mean the withdrawal as to the other.*" 522 F. 2d at 1046, emphasis added.

24. In summary, the *North Carolina I* and the *North Carolina II* decisions, which involved fundamental changes in the practice and even in the structure of the telecommunications industry, are the clearest enunciation of the *governing principle* that FCC jurisdiction under the Communications Act extends to all equipment employed for the provision of telephone service, since all such equipment is used, at least in part, for interstate or foreign communications. *Accord, Puerto Rico Telephone Company v. FCC*, 553 F. 2d 694 (1st Cir. 1977); *People of the State of California v. FCC*, 567 F. 2d 84 (D. C. Cir. 1977), cert. denied 434 U.S. 1010 (1978); *Southern Pac. Communications v. Corp. Com'n.*, 586 P. 2d 327 (Okla., 1978); *Clifton v. Cox*, 549 F. 2d 722, 730 (9th Cir. 1977); *New York Tel. Co. v. FCC*, 631 F. 2d 1059 (2d Cir. 1980); *GTE Service Corp. v. FCC*, 474 F. 2d 724 (2d Cir. 1973); *General Telephone Company of California v. FCC*, 413 F. 2d 390 (D.C. Cir. 1969).

25. In the cases discussed above, decided in the First, Second, Fourth, and D. C. Circuits, board statutory authority of the FCC was found to support the preemptive action taken. The FCC's authority and indeed, mandatory duty, under Section 220(b) of the Act, to prescribe depreciation rates is considerably more specific than the statutory basis for the FCC actions held to preempt the states in the foregoing cases. All of these recent cases make absolutely clear the jurisdictional base for FCC authority to carry out its duty under Section 220(b).

26. The unambiguous language of Section 220(b) of the Act demonstrates that Congress has in fact empowered and directed the FCC to set depreciation rates for all equipment and plant. General is fully subject to FCC jurisdiction, including the provisions of Section 220 which are concerned with the setting of depreciation rates for all of the company's plant and equipment:

> "Sec. 220(b) The Commission *shall*, as soon as practicable, *prescribe* for such carriers the classes of property for which

depreciation charges may be properly included under operating expenses, and *the percentages of depreciation* which *shall* be charged *with respect to each of such classes of property*, classifying the carriers as it may deem proper for this purpose. The Commission may, when it deems necessary, modify the classes and percentages so prescribed. Such carriers *shall* not, after the Commission has prescribed the classes of property for which depreciation charges may be included, charge to operating expenses any depreciation charges on classes of property *other than those* prescribed by the Commission, or, after the Commission has prescribed percentages of depreciation, charge with respect to any class of property a percentage of depreciation *other than* that prescribed therefor by the Commission. No such carrier shall in any case include in any form under its operating or other expenses any depreciation or other charge or expenditure included elsewhere as a depreciation charge or otherwise under its operating or other expenses." (Emphasis added)

27. Section 220(b) explicitly spells out the FCC's *responsibility* to prescribe both the classes of property for depreciation purposes, and the percentages of depreciation for each class, which was recognized by the Commission in Docket No. 20188. See 83 FCC 2d at 272, 273. Futhermore, in addition to assigning these responsibilities to the FCC, Congress explicitly (and with redundant emphasis) prohibited carriers from departing from any FCC prescriptions in various paragraphs of Section 220. See Subsections (b) and (g):

> "... *it shall be unlawful for such person to keep any other accounts, records, or memoranda than those so prescribed or such as may be approved by the Commission or to keep the accounts in any other manner than that prescribed or approved by the Commission....*" 47 U.S.C. Section 220(g), (emphasis added.)

Sections 220(d) and (e) contain provisions for the assessment of civil or criminal penalties upon persons failing or refusing to abide by the Commission-prescribed standards.

28. Congress could not have expressed its intent in more lucid and unambiguous language. The FCC has the power, in its discretion under Section 220(a), to prescribe accounting requirements for carriers, and it has the duty and responsibility under Section 220(b) to prescribe depreciation methodology and accrual rates. Once the FCC prescribes "the classes of property for which depreciation may be properly included under operating expenses, and the percentages of depreciation," the carriers are required to comply, and are subject to forfeitures and/or prosecution for failure to comply.

29. Congress recognized the importance of the FCC's obtaining the views of state commissions in the course of prescribing accounts, records, and memoranda. In Subsection (i) of Section 220 of the Act, it was provided that:

> "(i) The Commission before prescribing any requirements as to accounts, records, or memoranda, shall notify each State Commission having jurisdiction with respect to any carrier involved, and shall give reasonable opportunity to each such commission to represent its views, and shall receive and consider such views and recommendations."

30. Finally, the concluding subsection to Section 220 reinforces the clear intent of Congress that the FCC alone would act, but would seek the advice and counsel of state commissions:

> "(j) The Commission shall investigate and report to Congress as to the need for legislation to define further or harmonize the powers of the Commission and of State Commissions with respect to matters to which this section relates."

31. In view of the unambiguous language of Subsections (i) and (j) of Section 220 of the Act, one must ask why Congress would direct the FCC to seek out state commission opinions and views if: (a) the states were to have the final authority on "intrastate" depreciation rates; or, alternatively, (b) if Section 220 was to be applied solely to "interstate" equipment and plant (assuming *arguendo* that there is such a segregable body of equipment and plant) which would clearly be solely under FCC cognizance. The answer to both of these questions is that Con-

gress intended that the FCC should be the final arbiter of depreciation rates for *all classes of property*.

32. In contrast to the Communications Act, provisions of two other Acts enacted close in time to the Communications Act, the Natural Gas Act and the Federal Power Act, provide explicitly that depreciation rates prescribed by the relevant federal commission are not to be binding upon State Commissions in intrastate ratemaking.[4] Thus, Congress was quite capable of reserving State Commission authority to determine depreciation rates for intrastate ratemaking when it wished to do so. However, with the Communications Act, Congress withheld such authority from the states.

VI. FAILURE TO PREEMPT INCONSISTENT STATE DEPRECIATION RATES WILL RESULT IN WIDESPREAD DISREGARD BY THE STATES OF FCC DEPRECIATION ORDERS

33. The PUCO's April 26, 1982 Order (Exhibit A) is one of a growing number of instances where the states have refused to accept the depreciation orders of this Commission. In Ohio, it appears that at least two other telephone companies will be similarly affected. The PUCO refused to accept FCC prescribed

[4] Section 9(a) of the Natural Gas Act, 15 U.S.C. § 717h(a) (June 21, 1938) provides:

> "Nothing in this section shall limit the power of a State Commission to determine in the exercise of its jurisdiction, with respect to any natural-gas company, the percentage rates of depreciation or amortization to be allowed, as to any class of property of such natural-gas company, or the composite depreciation or amortization rate, for the purpose of determining rates or charges."

Section 302(a) of the Federal Power Act, 16 U.S.C. § 825a(a) (August 26, 1935) provides:

> "Nothing in this section shall limit the power of a State Commission to determine in the exercise of its jurisdiction, with respect to any public utility, the percentage rate of depreciation to be allowed, as to any class of property of such public utility, or the composite depreciation rate, for the purpose of determining rates or charges."

depreciation rates for terminal equipment accounts for the Ohio Bell Telephone Company in Case Nos. 81-436-TP-AIR and 80-1010-TP-AAM, Opinion and Order of April 21, 1982. Further, General is informed that in a recent three-way meeting between the staffs of this Commission, the Ohio and Kentucky Commissions, and Cincinnati Bell, Inc., the Ohio Staff again refused to accept the use of equal life group and remaining life depreciation methodology, although agreeing to the underlying average service lives and average net salvage values.

34. As noted by this Commission in its Memorandum Opinion and Order in CC Docket 79-105, FCC 82-155 released April 27, 1982, the California Commission, with the approval of the California Supreme Court, has refused to accept depreciation methods prescribed by this Commission. *Pacific Tel. & Tel. Co. v. California*, 401 P. 2d 353, 372-73 (1965). This Commission further noted that the Florida Public Service Commission has concluded that it is not required to use depreciation methods prescribed by this Commission. *Southern Bell Telephone & Telegraph Co.*, 66 PUR 3d 1, 57-58 (1966).

35. The Alabama Public Service Commission has served notice that it will not follow depreciation prescriptions of this Commission. Re *Telephone Terminal Equipment & Accounting Practices*, General Order, July 17, 1981, 43 PUR 4th 645, 648. The Nebraska Public Service Commission has issued a similar order. See Opinion and Findings dated September 1, 1981, regarding proposed Rule & Regulation 54. So has the Louisiana Public Service Commission. See General Order dated June 30, 1981. While the primary focus of these decisions is the FCC's Second Computer Inquiry, they also challenge FCC authority to act preemptively under Section 220 of the Communications Act in matters of accounting practices and depreciation. The Staff of the Michigan Public Service Commission has taken the position of refusing to accept depreciation accrual rates prescribed by this Commission in *In the Matter of the Application of General Telephone Company of Michigan for Approval of Depreciation*

Practices, Case No. U-6587, presently pending before the Michigan Public Service Commission.[5]

36. Public Service Commissions in thirteen states filed initial comments in Docket No. 20188, seven of which (California, Colorado, Florida, Kentucky, Maryland, New York, and Wisconsin) were discussed in the Commission's Report and Order. As stated by the Commission, "The principal reason given by the State Commissions for opposing ELG was that its adoption would result in an increase in revenue requirements. . . ." (Paragraph 41) Following the release of the Commission's Report and Order in Docket 20188, the National Association of Regulatory Utility Commissioners (NARUC) filed a Petition for Reconsideration, arguing that the adoption of ELG and the use of remaining life "will substantially increase revenue requirements and thereby subscriber rates." The Commission rejected NARUC's concern for increased revenue requirements as not inconsistent with the Commission's mandate under Section 1 of the Act, and further rejected alternatives suggested by NARUC as not dealing "with the need to improve capital recovery promptly in light of competitive and technological conditions in the marketplace." *Reconsideration,* paragraphs 5, 6.

37. The foregoing discussion provides some indication of the turmoil existing and in prospect at the state level following from months of delay by the Commission in issuing its reconsideration decision in CC Docket 79-105. The action of the PUCO in ordering depreciation rates in conflict with FCC-prescribed rates presents this Commission with a specific case of actual federal/state conflict involving over $7 million in depreciation charges. The Commission should resolve this matter by prompt, decisive action affirming the FCC's jurisdictional power and

[5] Although it has not had the opportunity to review commission decisions in the following states, General is informed that in addition to those states mentioned above, jurisdictions recently denying proposed remaining life and/or ELG depreciation rates include the following: District of Columbia, Georgia, Idaho, Kansas, Maryland, Massachusetts, Pennsylvania, South Carolina, South Dakota, Washington, and West Virginia.

making unmistakable the Commission's intention to see actual recovery of capital under its Docket 20188 policies.

SUMMARY

In summary, General submits that the PUCO's Order of April 26, 1982 is inconsistent with the Orders of this Commission released January 28, 1982 (FCC 82-40) and February 3, 1982 (FCC 82-53), and that the PUCO's Order frustrates policies which this Commission has adopted to carry out its statutory objectives. The PUCO's Order rejects equal life group and remaining life depreciation methodologies, methodologies which this Commission has specifically prescribed for General and has determined are appropriate and necessary in order for carriers to realize full capital recovery, and to take advantage of new technology which is necessary to improve telecommunications service.

RELIEF REQUESTED

WHEREFORE, General asks that the Commission issue its Order preempting the use by the PUCO, for General, of any depreciation accural rates and methods other than those prescribed by this Commission.

Respectfully submitted,

/s/ Richard McKenna
RICHARD McKENNA
One Stamford Forum
Stamford, Connecticut 06904
Telephone: (203) 965-2231

/s/ Andrew T. Jones
ANDREW T. JONES
100 Executive Drive
Marion, Ohio 43302
Telephone: (614) 383-0248

Attorneys for General
Telephone Company
of Ohio

EXHIBIT "A"

Opinion and Order, May 19, 1981, at p. 13 and *Ohio Bell Telephone Company*, Case No. 79-1184-TP-AIR, Entry on Rehearing, January 29, 1981, at p. 1.

Postage Expense Increase

The applicant objected to the Staff's failure to adjust operating expenses to reflect the annualization of the postage expense increase which became effective on November 1, 1981. Staff witness Montgomery agreed with this objection and revised his total jurisdictional postage expense adjustment from $50,354 in the Staff Report (Staff Ex. 1, Schedule 3.10) to $189,869 (Staff Ex. 13A, Schedule RGM-3). The Commission will adopt the Staff's revision.

Rate Case Expense

Consumers' Counsel raised its traditional objection to the inclusion of rate case expense. OCC witness Miller stated that if the Commission were to include rate case expense as an allowable operating expense, he would support the Staff's recommended two year amortization period (OCC Ex. 1, p. 21). As we have stated in numerous cases, the preparation, filing and prosecution of rate cases constitute a normal and necessary part of a utility's operations, and must therefore be reflected in the cost of service. *See, e.g., Cleveland Electric Illuminating Co.*, Case No. 78-677-EL-Air, Opinion and Order, May 2, 1979, at p. 26. The Commission will overrule this objection and permit an allowance of the estimated rate case expense of $75,961 amortized over two years or a test year allowance of $37,980.

Trustee Expense

The Staff did not include as an allowable expense the applicant's proposed trustee expense adjustment of $12,000 on a total company basis. Company witness King testified that General retains the services of the National City Bank of Cleveland and the Chemical Bank New York Trust Company to serve as trustees for first mortgage bond, debenture and supplemental indentures. The duties of these trustees include registering bonds,

authenticating bonds, cancelling and destroying bonds and coupons, keeping lists of bond holders, mailing reports to bond holders, holding undelivered bonds, maintaining ledger accounts for the bonds, and reporting on the issuance and transfer of bonds. In summary, the trustee expense is for the ongoing administration of bonds (Tr. XV, 20). These trustee expenses are charged to Account 323 and are not accounted for as legal expenses nor are they duplicated on Schedule D-3 of the Standard Filing Requirements. The Commission finds these expenses are ordinary and necessary utility business expenses and has included a jurisdictional allowance of $9,000 for trustee expense.

Depreciation Expense (Case Nos. 80-1124-TP-AAM and 81-354-TP-AAM)

A brief summary of the history of the proceedings in the above cases was set forth at the outset of this Opinion and Order and need not be repeated. The question of the appropriate depreciation accrual rates to be authorized and utilized for purposes of setting rates has been consolidated into these cases. Annual depreciation accrual rates are prescribed every three years for General by both the FCC and this Commission. Since the items in each plant account are used for both interstate and intrastate service, the appropriate accrual rates are generally agreed upon by both Commissions as a result of a three way meeting between representatives of the applicant and the staff of the FCC and of this Commission. However, at the three way meeting held on June 11 and 12, 1981, the three parties agreed only on the average service lives and average net salvages. The applicant and the staff of the FCC advocated use of "remaining life" rates and the use of the equal life group (ELG) procedure of grouping property units. The staff of this Commission recommends the use of "whole life" rates as proper and adequate as well as the vintage group procedure. The company objected to the Staff's recommendations.

By its Report and Order in Docket No. 20188 released December 5, 1980, the FCC indicated that it would amend its rules to permit the use of remaining life depreciation rate calculations. In its Order in FCC 82-40 30744 released January 28, 1982, the

FCC authorized the use of remaining life rates for GTO. On February 3, 1982, the FCC released its Order prescribing ELG rates for General's outside plant accounts, effective January 1, 1982.

In the context of this rate case, the issue, of course is whether remaining life and/or ELG rates on the one hand, or the use of whole life and vintage group rates on the other hand, should be used for purposes of determining the proper allowance for depreciation expense. This question is of more than academic interest, for the difference in expense dollars between the two sets of rates is approximately $7 million (Co. Ex. 52, King Ex. 15; Tr. XIV, 67). The Commission perceives this issue as involving a legal question as well as a policy question. For purposes of discussion, we will discuss the legal question first, followed by the remaining life rates versus whole life rates issue, and finally, an examination of equal life group procedures and vintage group procedures.

The threshold question which must be addressed, if not decided, is whether the Commission has any discretion at all in the matter. Applicant argues federal preemption, contending that the FCC's prescription of remaining life depreciation rates forecloses this state commission from reaching a contrary result. This places the Commission in a somewhat awkward position for, on the one hand, it is not our province to decide constitutional questions, while, on the other, we must make some determination as to our authority to proceed. On brief, Staff counsel points out that the Commission has a duty under Section 4905.18 Revised Code to "ascertain, determine, and prescribe what are proper and adequate charges for depreciation . . . " and that the Commission "may prescribe such changes in such charges for depreciation as it finds necessary" (Staff Initial Brief, p. 24). Moreover, in establishing rates for utility service, the Commission must give due regard to the "necessity of making reservation out of the income for . . . depreciation . . . " Section 4909.15(D)(1) Revised Code. (*See also* Section 4909.05(H) Revised Code). Pursuant to this obligation and authority we will take up the merits of the depreciation controversy, leaving the constitutional question to other forums. To decide the preemption issue would require us to rule on the constitutionality of the cited statutes or to simply

disregard the duties they impose. Neither alternative is acceptable. We would note in passing, however, that none of the arguments advanced by applicant would appear to us to compel the conclusion that the federal government, through the FCC, has occupied the field; for the "field" is the setting of fair and reasonable rates for intrastate telephone service, an activity over which the FCC has no authority. Indeed, in the only judicial decision cited to our attention which involves this precise question, the preemption argument was rejected. *Pacific Telephone and Telegraph Co. v. Public Utilities Commission*, 401 P.2d 353, 372-373, 58 PUR 3d 229, 253-254 (1965). Further, requiring the applicant to maintain different accrual rates with respect to its interstate and intrastate property creates no conflict and places no undue burden on the company as it has been ordered by the FCC to maintain both whole life and remaining life depreciation studies during the next represcription period in any event.

Staff witness Fox testified in support of depreciation accrual rates derived from the whole life methodology (Staff Ex. 11, pp. 6-27; generally Tr. XIV). Company witnesses Dennis and White testified in support of the use of remaining life rates (Co. Ex. 24, p. 15; Tr. V, 154-162; VI, 63-120; VII, 63, 75, 99; Co. Ex. 59; Tr. XXII, 7-58). We will review briefly the mechanics of the two techniques.

Under the whole life method, the depreciation accural rate is determined by dividing the original cost of an asset or vintage group of assets, less average net salvage, by the estimated average service life. If the estimate of average service life changes for any reason, a new depreciation rate is determined based on the new estimate. The rate so determined is the same as the rate which would have been in effect had the initial service life estimate been correct. Under the remaining life approach, the process is the same up to the point where the average service life estimate changes. The new accrual rate is then determined by dividing the undepreciated portion of the original cost of the asset or vintage group, less net salvage, by the average remaining life. Thus, the remaining life accrual rate is, essentially, whatever rate is necessary to produce a total return of the initial capital.

The principal evil of the whole life methodology in applicant's view is that it does not provide for complete capital recovery under conditions of rapidly changing technologies where service lives, particularly in the terminal equipment area, are heavily influenced by competitive forces (Co. Initial Brief, pp. 53-55). As applicant maintains, under whole life, the depreciation reserve will, as a mathematical certainty, eventually end up over- or underaccrued whenever there has been change in the estimated average service life. In earlier years, where these competitive forces were not as pervasive, this was of no great moment, for over- and underaccruals were presumed to generally cancel one another out. However, with the onset of competition, the environment is no longer unbiased, and changes in service life estimates are no longer basically related to new perceptions of an item's physical properties, but rather to technological obsolescence. Thus, the company argues, the remaining life procedure must be used in order to allow full capital recovery.

The whole life proponents, although conceding that the remaining life method is designed to permit a full return of capital, contend that the technique is inconsistent with proper regulatory theory, is not permissible under Ohio law, and, as a practical matter, is no more likely to produce an accurate result than the whole life method, We find something of merit in each of these arguments. We turn first to the theoretical questions.

Depreciation is nothing more than a procedure by which to allocate the cost of an asset over its life (Staff Ex. 11, p. 7; Co. Ex. 59, p. 6; Tr. XXII, 9-11). Under the straight line methods used for book accounting and regulatory purposes, the assumption is that the cost should be distributed equally over the asset's life, or in the case of a vintage group, over the average life of the assets comprising the group. Thus, when evidence indicates that the original life estimate was incorrect, even though it represented the best judgment possible at the time, it is clear that there has been a misallocation of cost. The whole life method does not attempt to correct for this past misallocation. Whole life depreciation accrual rates merely generate the annual expense which would have been incurred had the original service life estimate been correct. In the context of the ratemaking process, this means that the current

ratepayer is asked to pay only what he would have been charged for depreciation expense if the proper accrual rates had been in place, from the time the asset or vintage group of assets was placed in service. Given the nature of the ratemaking process, this can certainly be viewed as an appropriate standard by which to determine a reasonable allowance for depreciation expense. The remaining life method, on the other hand, attempts to remedy this past misallocation by charging current ratepayers for the past underrecovery of depreciation expense (Tr. VII, 99). As discussed below, there may be legal constraints which preclude this result, but some comment is in order relative to the conceptual problems posed by this aspect of the remaining life technique. This attempt to correct for past misallocations shifts certain risks properly borne by the company's investors to its ratepayers. The most obvious of these is what might be loosely referred to as regulatory risk, that is, the risk which flows both from the fact of regulation and from individual regulatory decisions. The more significant risks for purposes at hand, however, are the business risks associated with applicant's competitive endeavors, here, specifically, the risk of technological obsolescence. The remaining life method tends to insulate the investor from all this.

From a legal standpoint, remaining life is on something less than solid ground. This Commission has previously been presented with proposed depreciation accrual rates utilizing remaining life rates and has rejected such rates primarily because we found it would be unfair to make present and future ratepayers "pay for the past inadequacy" of past depreciation rates. *See, e.g. Dayton Power and Light Co.*, Case No. 79-372-GA-AIR, Opinion and Order, May 7, 1980, at p. 14. We also believe that the implications of *C&SOE v. Pub. Util. Comm.* (1980), 64 Ohio St.2d 175 and *Consumers' Counsel v. Pub. Util. Comm.* (1981), 67 Ohio St.2d 153 address this issue. Although these decisions are not on all fours factually with the instant case, the Ohio Supreme Court's pronouncements with respect to the impropriety of recovering past losses through present and future rates can certainly not be ignored. Of particular interest is the fact that the Court did not view the reasonableness or prudence of the initial decisions, be it the Commission's, as in *Columbus and Southern, supra,* or management's, as in *Consumers' Counsel, supra,* to be material to

the question of whether the loss occasioned thereby could be recognized through future rates. Here, the present accrual rates were fixed by the Commission based on the best evidence available at the time. The fact that the estimate of service lives has not changed does not justify charging the present ratepayers for this past misallocation.

Although there is something attractive about the symmetry of the remaining life method with its nominal full return of capital, the realities of the situation are such that there is no real assurance that remaining life, particularly as it has been calculated in this case, will yield a more reasonable result than the whole life method. The first point to be made in this connection is that if an asset has not been fully depreciated at the end of its actual useful life, the dollars associated with the undepreciated portion remain in the account in question. This is not to suggest that it is desirable to create this increment of permanent rate base, but merely to point out that the company does continue to realize a return on that portion of the asset that is not refunded through depreciation accruals (Tr. VI, 73). If we were dealing with a single item of property, this permanent rate base phenomenon would be a matter of some concern, but the fact is that we are dealing here with mass accounts subject to a continual stream of additions and retirements. Individual items within the accounts will be overaccrued or underaccrued at any point in time regardless of the depreciation method adopted. Moreover, under remaining life, all additions after the represcription will necessarily be overaccrued.

The results under remaining life might be slightly more tolerable if one could be absolutely assured that the additional costs associated with the use of the method would be charged specifically to the items of equipment with which the increased expense is associated. However, as General's service offerings are not tariffed pursuant to a comprehensive, fully allocated cost study, there is no such guarantee. Thus, under remaining life, not only are customers required to bear the risk of technological obsolescence; some are asked to bear this risk in connection with services that, in most instances, they cannot even use.

With due regard for these considerations, the Commission is of the opinion that the whole life depreciation rates recommended by the Staff produce a reasonable allowance for depreciation expense. We will utilize the whole life method here.

General also proposed using the equal life group method in determining depreciation expense for outside plant accounts. This method was authorized by the FCC effective January 1, 1982. The equal life group method is a refinement of the vintage life group procedure. Whereas the vintage life group attempts to group property units which were placed into service at about the same year, the equal life group method goes one step further and attempts to group "property units within a vintage that are expected to have the same service life" (Co. Ex. 59, p. 8). Mr. Dennis testified that the equal life group (ELG) or unit summation approach is more precise because it recognizes that some assets in a functional group are retired before the average for the group, and other assets remain in service longer than the average (Tr. VII, 55-56).

The Staff generally supported the concept of the ELG method but recommended disapproval in this case. We agree with the Staff that the effect of the ELG method has not been isolated from the proposed remaining life rates. The commission will adopt the whole life-vintage group rates recommended by the Staff. The applicant's objection will be overruled.

(6) The company should be authorized to cancel and withdraw its current tariffs on file with this Commission and to file revised proposed tariffs consistent in all respects with the discussion and findings set forth above.

(7) General's existing rate structure for competitive communications systems and equipment is unjust, unreasonable and unjustly discriminatory in that it prevents the company from responding promptly to changes in competitive market conditions and effectively, from optimizing the contribution from such systems and equipment.

(8) The flexible rate structure for competitive communications systems and equipment providing for minimum and maximum rate levels, as set forth in the proposed tariff

regulation in this case, will reduce the unjust discrimination inherent in competition between regulated and unregulated suppliers.

ORDER:

It is, therefore,

ORDERED, That the application of General Telephone Company of Ohio for authority to increase its rates and charges for telephone service be granted to the extent provided in this Opinion and Order. It is, further,

ORDERED, That the company is authorized to normalize the tax benefits from the accelerated cost recovery system of depreciation and the investment tax credit on its recovery property placed in service after December 31, 1980. It is, further,

ORDERED, That the company is authorized to cancel and withdraw its present tariffs and to file revised proposed tariffs consistent with the discussion and findings set forth above. Upon receipt of three (3) copies of revised proposed tariffs conforming to this Opinion and Order, the Commission will review and if appropriate, approve the tariffs by Entry. It is, further,

ORDERED, That the effective date of the new tariffs shall be the date said tariffs are accepted for filing by Commission Entry. The new rates included therein shall be applicable to all service rendered on and after the effective date. It is, further,

ORDERED, That the company submit a proposed notice of the increase in rates and charges authorized in this Opinion and Order when it files its tariffs for approval. The Commission will review the proposed notice and, if proper, approve it by Entry. Upon approval of the notice, the company shall immediately begin to notify its customers by insert or attachment to its billings, by special mailing, or by a combination of the above. Notice to customers should be completed within thirty (30) days of the approval of the tariffs and the notice. It is, further,

ORDERED, That the new depreciation accrual rates prescribed in this Opinion and Order be applied to its intrastate plant commencing May 1, 1982, and shall continue to be applied until the Commission orders otherwise. It is, further,

EXHIBIT "B"

FEDERAL COMMUNICATIONS COMMISSION
Schedule of Annual Percentages of Depreciation for
GENERAL TELEPHONE COMPANY OF OHIO

Acct. No.	Class or Subclass of Plant	Avg. Serv. Life (Yrs.)	Avg. Net Salv. (%)	Whole Life Rate (%)	Avg. Rem. Life (Yrs.)	Fut. Net Salv. (%)	Rem. Life Rate (%)
212	Buildings	30	8	3.1*			
221	Central Office Equipment						
	Manual Switching				5.8	−4	13.3
	Automatic Sw (Electro-Mech)				6.7	1	9.3
	Automatic Sw (Analog)				18.1	1	4.9
	Automatic Sw (Digital)				25	1	4.0
	Automatic Message Recording				6.1	1	11.4
	Circuit				12	11	5.6
	Radio				8.2	2	6.5
231	Station Apparatus						
	Telephone				7.1	1	11.3
	Small PBX				2.7	1	36.2
	Telephone Booths				7.8	0	13.9
	Teletypewriter				6.3	1	10.2
	Radiotelephone				6.9	0	8.7
232	Station Connections—Other				—	—	5.0#
234	Large Private Branch Exchanges				5.1	3.5	13.0
241	Pole Lines				11.9	−36	9.3
242.1	Aerial Cable				22	−18	3.9
242.2	Underground Cable				24	22	4.0
242.3	Buried Cable				26	−5	3.4
242.4	Submarine Cable				12.8	0	4.9
243	Aerial Wire				5.3	−67	57.8
244	Undergound Conduit				48	−12	1.8
261	Furniture & Office Equipment				15.7	12	3.0
264	Vehicles & Other Work Equipment						
	Motor Vehicles				4.5	13	9.3
	Shop Equipment				7.8	5	9.3
	Tools & Other Work Equipment				13.5	11	4.1

*Depreciation rate prescribed previously

#This rate is not based upon life and salvage factors

All rates are effective December 1, 1981 except Account No. 232 which is effective October 1, 1981

EXHIBIT "C"

FEDERAL COMMUNICATIONS COMMISSION
Schedule of Annual Percentages of Depreciation
Calculated under the Equal Life Group Methodology for
GENERAL TELEPHONE COMPANY OF OHIO
Effective January 1, 1982

Acct. No.	Class or Subclass of Plant	Serv. Life (a) (Yrs.)	Net Salv. (b) (%)	Curve Shape (c)	ELG Rates for 1982 and Later Vintages — Age at Beginning of Year 0.0 (d) (%)	0.5 (e) (%)	1.5 (f) (%)	Net Salv. Rate (g-b/a) (%)
241	Pole Lines	20	−36	*	12.3	8.9	7.3	1.8
242.1	Aerial Cable	30	−18	*	5.6	4.7	4.3	0.6
242.2	Underground Cable	32	−22	*	5.3	4.4	4.0	0.7
242.3	Buried Cable	32	− 5	*	4.1	3.9	3.8	0.2
242.4	Submarine Cable	23	0	R2	6.5	5.8	5.5	0
244	Underground Conduit	60	−12	R2	2.6	2.4	2.3	0.2

* A Gompertz-Makeham Curve using the c, G & S values provided in the carrier's studies.

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GENERAL TELEPHONE COMPANY OF OHIO
Case No. 81-383-TP-AIR
Jurisdictional Depreciation Expense
($000's Omitted)

Acct. No.	Account Description	Jurisdictional Plant in Service (a)	Accrual Rate % (b)	Jurisdictional Depreciation Expense (c)
201	Organization	$ 22	0.0	$
202	Franchise		0.0	
203	Patent Rights		0.0	
211	Land	2,885	0.0	
212	Buildings	46,315	3.1	1,436
221	*Central Office Equipment*			
	Manual Switching	6,152	8.1	498
	Automatic Switching	144,859	6.8	9,850
	Automatic Message Recording	17,132	8.1	1,388
	Circuit	57,163	5.4	3,087
	Radio	858	6.3	54
231	*Station Apparatus*			
	Telephone Station	50,712	9.3	4,716
	Small PBX	2,045	13.9	284
	Booths	753	8.9	67
	Teletypewriter Equipment	2,228	10.5	234
	Radiotelephone Equipment	274	10.0	27
232	*Station Connections*			
	Telephone	53,249	13.1	6,976
	Teletypewriter	174	13.1	23
	Radiotelephone	53	13.1	7
234	Large PBX	12,456	11.2	1,395
241	Pole Lines	19,104	6.4	1,223
242.1	Aerial Cable	88,911	4.0	3,556
242.2	Underground Cable	15,819	3.8	601
242.3	Buried Cable	77,125	3.5	2,699
242.4	Submarine Cable	98	4.0	4
243	Aerial Wire	3,705	15.5	574
244	Underground Conduit	7,054	1.9	134

(a) Staff's Schedule 8
(b) Refer to Text
(c) = (a) x (b)

EXHIBIT "D"
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GENERAL TELEPHONE COMPANY OF OHIO
Case No. 81-383-TP-AIR
Jurisdictional Depreciation Expense
($000's Omitted)

Acct. No.	Account Description	Jurisdictional Plant in Service (a)	Accrual Rate % (b)	Jurisdictional Depreciation Expense (c)
261	Furniture & Office Equipment	$ 5,039	4.0	$ 202
264	*Veh. & Other Work Equipment*			
	Motor Veh.	11,108	12.4	(d)
	Motor Veh. Shop Equipment	139	9.2	(d)
	Tools & Other Work Equipment	6,996	5.0	(d)
276	Telephone Plant Acquired		0.0	
277	Telephone Plant Sold	(1)	0.0	
	Subtotal	632,427	6.17(e)	39,035
	Station Connection-Inside Wiring Adjustment(f)	(405)	—	(2,623)
	Total Depreciation & Amortization Expense	$632,022	5.76(e)	$36,412

(a) Staff's Schedule 8
(b) Refer to Text
(c) = (a) x (b)
(d) Charged to Clearing Account
(e) Composite—Shown for Illustration Only
(f) Drop at 5% = 964,478 plus Amortization of 4,795,010 = 5,759,488 Less Current Total 232 Expense of 9,201,815 = $3,442,327 decrease in Total Company Expense x .761909 = $2,622,740

EXHIBIT "E"
Page 1 of 3

THE EFFECT OF DIFFERENT JURISDICTIONAL DEPRECIATION RATES IN THE PRESENCE OF CHANGING JURISDICTIONAL ALLOCATION FACTORS IS TO PREVENT 100% CAPITAL RECOVERY

The attached examples show that the use of different depreciation methodologies for the interstate and intrastate portions of General's plant accounts will not achieve the objective of one hundred percent capital recovery—no more and no less—except by sheer and remote chance. This is because jurisdictional allocation factors are based on changing usage studies (of both holding times and message volumes) and are revised monthly. Investment and expenses, including depreciation, allocated to interstate and intrastate services, change monthly for purposes of jurisdictional separations and settlements as a result of usage changes. The use of different depreciation rates for interstate and intrastate purposes will mean either (i) that General will *never realize* full capital recovery, or (ii) General will realize an *over-recovery*. In either case, the ratepayer will be disserved.

To illustrate the effect of changing jurisdictional allocation factors, Schedule E-1 and Schedule E-2 set forth a Single Asset Example with two variations in the separations factors over four years.

As shown in Schedule E-1, on an original investment of $100, General would recover only $98.75, resulting in failure *ever* to recover $1.25, constituting 1.25%, of the original investment—even though both the interstate and intrastate "books" would indicate full capital recovery.

Conversely, as shown in Schedule E-2, on an original investment of $100, General would recover $101, for a $1 over-recovery, even though both sets of "books" would indicate nothing more than full capital recovery.

These illustrations are intended to frame the problem in simplified, understandable terms. The conflict between FCC prescriptions of depreciation methodologies and rates and state determinations must necessarily result in destroying any assurance that the depreciation process will be allowed to work as intended, providing recovery of just the amount invested, not more, not less.

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SCHEDULE E-1

SINGLE ASSET EXAMPLE

Given:
- $100 Single Asset
- $ 0 Net Salvage
- 4 Year Physical Life
- 4 Year Depreciation Life—State—Whole Life
- Initial 3 Year Depreciation Life—Interstate—Remaining Life Revised at End of Year 2 to 2 Years Remaining
- Separation Changes as Shown Below:

	YEAR 1	2	3	4	Total of Years 1-4
1. Separation Factor State	.80	.75	.70	.70	N/A
2. Separation Factor Interstate	.20	.25	.30	.30	N/A
STATE BOOKS					
3. Total Recorded Depreciation	$25.00	$25.00	$25.00	$25.00	$100.00
4. State Rev. Rqmt. Dept. (line 1 × line 3)	20.00	18.75	17.50	17.50	73.75
INTERSTATE BOOKS					
5. Total Recorded Depreciation	33.33	33.33	16.67	16.67	100.00
6. Interstate Rev. Rqmt. Dept. (line 2 × line 5)	6.67	8.33	5.00	5.00	25.00
COMPOSITE					
7. Total Capital Recovered (line 4 + line 6)	$26.67	$27.08	$22.50	$22.50	$ 98.75

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SCHEDULE E-2

SINGLE ASSET EXAMPLE

Given:
- $100 Single Asset
- $ 0 Net Salvage
- 4 Year Physical Life
- 4 Year Depreciation Life—State—Whole Life
- Initial 3 Year Depreciation Life—Interstate—Remaining Life Revised at End of Year 2 to 2 Years Remaining
- Separation Changes as Shown Below:

	YEAR 1	2	3	4	Total of Years 1-4
1. Separation Factor State	.70	.75	.80	.80	N/A
2. Separation Factor Interstate	.30	.25	.20	.20	N/A
STATE BOOKS					
3. Total Recorded Depreciation	$25.00	$25.00	$25.00	$25.00	$100.00
4. State Rev. Rqmt. Dept. (line 1 × line 3)	17.50	18.75	20.00	20.00	76.25
INTERSTATE BOOKS					
5. Total Recorded Depreciation	33.33	33.33	16.67	16.67	100.00
6. Interstate Rev. Rqmt. Dept. (line 2 × line 5)	10.00	8.33	3.33	3.33	24.99
COMPOSITE					
7. Total Capital Recovered (line 4 + line 6)	$27.50	$27.08	$23.33	$23.33	$101.24

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

CC Docket 79-105

In the Matter of
Amendment of Part 31, Uniform System of Accounts for Class A and Class B Telephone Companies, of the Commission's Rules and Regulations with respect to accounting for station connections, optional payment plan revenues and related capital costs; customer provided equipment and sale of terminal equipment.

JOINT PETITION FOR CLARIFICATION

[Filed June 8, 1982]

GTE Service Corporation and its affiliated domestic telephone companies; United Telephone System, Inc., on behalf of the companies comprising the United Telephone System; and Continental Telecom Inc., on behalf of its telephone operating companies; ("the Joint Petitioners"), pursuant to Section 1.429 of the Commission's Rules, ask the Commission to clarify the Memorandum Opinion and Order (the order) released April 27, 1982, FCC 82-155, as follows:[1]

OVERVIEW

As it relates to depreciation, the Order does not reflect the Commission's intent.

Without clarification, the Order will have very serious effects, not intended by the Commission, imperiling established Commission policies and statutory objectives—including full and timely

[1] 47 Fed.Reg. 19361, May 5, 1982. The Petition meets the test of Section 1.429(b) in that its facts relate to change in scope of the original Order, upon which there has been no opportunity to comment. Moreover, the public interest requires the further reconsideration asked here.

recovery of invested capital under Docket 20188[2] and implementation of the Commision's CPE deregulation program under Docket 20828[3] and CC Docket 81-893.[4]

The Order (¶ 8) announces that "Section 220 [of the Communications Act] does not preclude state commissions from departing from accounting *or depreciation* rules prescribed by this Commission for purposes of regulating intrastate telecommunication service rates" (emphasis added). This conclusion sweeps well beyond station connection accounting. It embraces depreciation as well as accounting requirements; it embraces matters covered by § 220(a) as well as § 220(b) of the Act.[5] And yet the discussion in Part II[6] of the Order, cited to support this conclusion, is exclusively concerned with § 220(a) matters (accounting requirements) and provisions related thereto, particularly § 220(g).

No support for any conclusion whatever regarding § 220(b) matters (prescription of depreciation methodologies and rates) is found anywhere in Part II of the Order. Furthermore, the quoted conclusion would appear to permit *any* form of state departure from depreciation, as well as accounting, rules prescribed by the FCC. But the Part II discussion merely leads to the determination that "in this instance . . . federal regulation will not be frustrated if carriers maintain additional records for intrastate ratemaking purposes" (¶ 37). From a legal analysis which merely finds that the states may require additional records, with even that finding limited to the subject matter of this proceeding ("in this instance"), the quoted language of Paragraph 8 leaps to a universal conclusion evidently opening the door to unidentified state

[2] 83 F.C.C.2d 267 (1980), *reconsideration*, 87 F.C.C.2d 916 (1981).

[3] 77 F.C.C.2d 384 (1980), *reconsideration*, 84 F.C.C.2d 50 (1980), *further reconsideration*, 88 F.C.C.2d 521 (1981), appeals pending in D.C. Circuit.

[4] Notice of Inquiry, FCC 81-576 released April 13, 1982.

[5] Communications Act of 1934, 47 U.S.C. § 151 *et seq.*

[6] ¶¶ 9-37.

departures beyond requiring additional records, and thi without any discussion whatever of § 220(b).

Also included in the Order (¶¶ 33 and 34) are citations, with tacit approval, to state court or commission decisions rejecting FCC prescriptive power under § 220(b). It is astonishing to find in an Order of the FCC a reference, with apparent approval, to a California decision that the California commission "is not bound by the depreciation rates or methods set by the Federal Communications Commission. . . ." *See Pacific Tel. and Tel. Co. v. California*, 401 P.2d 353, 372-373, 58 P.U.R. 3d 229, 253-254 (1965).

Paragraph 37 of the Order sets out the governing principles recognized by the Commission and the courts in establishing the bounds of federal and state jurisdiction. It is there made clear that state actions, including state ratemaking, which imperil "important interests of national communications policy" will be preempted. But the language of the Order encompasses depreciation without any reference to the Commission's current depreciation policy, and implies Commission acceptance of state decisions rejecting FCC depreciation prescriptions without in any way considering the impact of such decisions of Commission policy objectives.

It is clear that there was no intent on the part of the Commission in adopting the Order to surrender any portion of its jurisdictional powers. The Commissioners were assured in open meeting that the Order would in no way undercut the Commission's ability to preempt inappropriate state action, and a favorable vote of the Commissioners proceeded only on these assurances. The unfortunate language of Paragraph 8, the apparent acceptance of state decisions rejecting FCC jurisdiction as "applicable state court precedents" (¶ 34), and various other elements of the Order discussed in this Petition, do not reflect either the Commission's intent or the intent of Congress as clearly expressed in the statute.

If not clarified, the Order will imperil Commission policies and objectives.

Without clarification, the Order will be read to signal a withdrawal of FCC decisional power, not only in terms of its Docket

20188 policies directed at timely capital recovery actually effected, but also as to implementation of CPE deregulation, where § 220(b) matters have been recognized time and again as an essential element in the Commission's program.[7] This is the worst time possible for a signal expressed in an FCC Order that it is uncertain of its own powers, just when the industry is embarking, under FCC mandate, on a complex transition from regulation to deregulation with billions of dollars in unrecovered CPE investment at stake.

The Order, without clarification, will create confusion and uncertainty even among state regulators disposed to accept FCC preemptive power. While the intent of the Commission was not to surrender its power, the language of the Order, and in fact the whole tenor of the Part II analysis, suggests otherwise. The result is that portions of the Order are being quoted out of context to support opposition to FCC prescriptions.[8] The effect of the Order at the state level is to provide ammunition for those who would argue that the California commission had the right idea all along in rejecting prescriptive FCC power in § 220(b).

A number of state commissions are proceeding to reject, in whole or in part, the FCC's depreciation policies and prescriptions. An example is recent action by the Public Utility Commission of Ohio. General Telephone Company of Ohio, one of the GTE telephone companies, is filing, concurrently with this petition, a petition seeking declaratory action. The Ohio company is faced with a clear conflict of federal and state depreciation decisions, with a differential between the two jurisdictions of more than $7 million in depreciation charges in the first year. Other jurisdictions have taken action, or are expected to take action

[7] *See*, for example, 84 F.C.C.2d at 68-69; and the Notice of Inquiry in CC Docket 81-893, ¶¶ 8-13 and 22.

[8] The Arkansas Public Service Commission has refused to give generic approval to remaining-life and ELG methods, preferring instead to "consider each company on its own merits." Order No. 3, Docket U-2989, May 7, 1982. The Arkansas PSC order was based on a staff recommendation that cited the FCC's Reconsideration Order in Docket 79-105 in support of state authority over depreciation of intrastate plant.

imminently, negating the effect of FCC prescriptions under § 220(b) as to depreciation methodologies and/or rates. Four United operating companies have been subject to state commission decisions on station connections expensing which vary from the commission's initial decision—with Nebraska denying permission to expense altogether.

The effect of this jurisdictional struggle will be to frustrate the FCC's policy directing timely recovery of invested capital, in the interests of ratepayers as well as carriers.[9] Moreover, as shown in the GTE Ohio company's petition, it will mean that the basic objective of depreciation, recovery of no more and no less than invested capital, cannot be realized. As we demonstrate in this Petition, Congress fashioned § 220(b) and related provisions precisely to prevent any such outcome.

DISCUSSION

The Order fails to recognize the critical distinction between § 220(a) and § 220(b).

The fundamental deficiency of the Order, as it deals with depreciation, is its failure to recognize the distinction between § 220(a) of the Act and § 220(b).[10] Congress carefully distinguished *discretionary* prescription under § 220(a) from *mandatory* FCC prescription under § 220(b), in the following language:

> Sec. 220(a) The Commission *may, in its discretion,* prescribe the forms of any and all accounts, records, and memoranda to be kept by carriers subject to this Act, including the accounts, records, and memoranda of the movement of traffic, as well as of the receipts and expenditures of moneys.

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[9] *See* 83 F.C.C. 2d at 275-277.

[10] The station connections expensing and amortization program of CC Docket 79-105 is at least as much a § 220(b) as a § 220(a) matter, since it essentially prescribes the depreciation expenses which will be allowed over a period of years.

> Section 220(b) The Commission *shall,* as soon as practicable, *prescribe* for such carriers the classes of property for which depreciation charges may be properly included under operating expenses, and the percentages of depreciation which *shall* be charged *with respect to each of such classes of property,* classifying the carriers as it may deem proper for this purpose. The Commission may, when it deems necessary, modify the classes and percentages so prescribed. *Such carriers shall not,* after the Commission has prescribed the classes of property for which depreciation charges may be included, charge to operating expenses any depreciation charges on classes of property *other than* those prescribed by the Commission, or, after the Commission has prescribed percentages of depreciation, charge with respect to any class of property a percentage of depreciation *other than* that prescribed therefor by the Commission. No such carrier shall in any case include in any form under its operating or other expenses any depreciation or other charge or expenditure included elsewhere as a depreciation charge or otherwise under its operating or other expenses. (Emphasis added)

With great clarity, Congress spelled out the FCC's:

> (i) *power* to prescribe ("The Commission may, in its discretion . . .") the full range of accounting requirements; and (ii) *responsibility* to prescribe ("The Commission shall, as soon as practicable . . .") both the classes of property for depreciation purposes, and the percentages of depreciation for each class.

With regard to § 220(b), Congress expressly prohibited carriers from departing from mandatory FCC prescriptions:

> Such carriers shall not, after the Commission has prescribed . . . charge . . . any depreciation charges . . . other than those prescribed by the Commission.

The Order fails to recognize that the Commission does not have to assume the onus of deciding the preemptive effect of its prescriptions of depreciation methodologies and rates. Congress

has determined that such prescriptions shall be conclusive by operation of law.[11]

In contrast, the FCC is explicitly provided with discretion as to accounting requirements under § 220(a). To reach the conclusion of Paragraph 37 of the Order as to any matter arising under § 220(a), that "federal regulation will not be frustrated if carriers maintain additional records for intrastate ratemaking purposes," no extensive legal analysis is required. The Commission is expressly given the discretion to make § 220(a) prescriptions non-preemptive, and it has done so in the past. *See* 68 F.C.C. 2d 902, 906-907 (1978), *reconsideration*, FCC 79-678 released November 6, 1979. But even under § 220(a), if the Commission decides to prescribe preemptively, § 220(g) makes clear the binding effect of any such action.

The legislative history of the Act, which is discussed in *Attachment 1* to this petition, reinforces the intent of Congress, clearly expressed in the statute itself, requiring the FCC to prescribe depreciation methodology and rates under § 220(b) and to assure compliance with its provisions prohibiting departures from such prescriptions. This Commission has explicitly recognized those obligations:

> This Commission is charged with the responsibility of approving depreciation rates for communications carriers subject to § 220(b) . . . . 87 F.C.C.2d at 923.

The Commission has recently interpreted 220(b) in docket 20188. Our next step is to consider the Commission's action in this important proceeding.

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[11] The FCC did not issue prescriptions under § 220(b) for the GTE telephone companies until 1976, evidently relying on the qualifying language of § 220(b), "as soon as practicable." Once prescriptions are issued, this qualification can have no application. The only provision of the Act in any other way qualifying the Commission's statutory obligation to prescribe, and to assure compliance with such prescription, is § 220(h), permitting exceptions for classes of carriers. No "classification of carrier" issue was raised in this proceeding, or would be relevant to prescriptions duly issued by the Commission.

The Commission's depreciation policies established in docket 20188, which recognized the impact on intrastate rates, must not be imperiled by state action.

The Commission's depreciation policies were articulated in Docket 20188 after many years of exhaustive study, by a decision reached on the unanimous vote of the Commissioners, and the Commission is continuing its very constructive effort to give practical effect to these policies.

In that proceeding, there was emphasis on the statutory base for Commission policy in § 220(a) and (b) of the Act. *See* 83 F.C.C. 2d a 272-273. Rules implementing § 220(b) were reviewed in detail, and new Rules adopted (at 273-275).

Most of all, the Commission focused on the substantive effect of depreciation. The Commission said "the purpose of depreciation is to make provision for recovery or charge of the original cost of the property by the end of its life" (at 275). With a number of citations to authorities, the Commission stressed the "principle of investor recovery of the whole cost of investment" (at 275-277). The authorities discussed made it clear that, in the event of inadequate provision for depreciation, the ratepayers bear the risk of loss (at 276-277). In view of these critical considerations of public policy, the Commission adopted a number of new approaches designed to protect ratepayers through timely capital recovery by telephone companies.

In approving remaining life and equal life group (ELG) methodologies (at 280-286 and 288-290), the Commssion recognized that it was carrying out the task assigned by § 220(b) of the Act. In so doing, the Commission rejected arguments of state commissions essentially based on the increases in rates which would follow FCC prescriptive action:

> We do not find increased rates [for subscribers] inconsistent, *per se*, with our mandate under Section 1 of the Act. . . . We must balance the interests of all present and all future customers in the preservation of adequate facilities at reasonable charges. On balance, we find it not unreasonable that present ratepayers incur some additional expense in order to preserve the integrity of the investment and to assure the

> continued and longer term satisfaction of the requirements of our congressional mandate. *The only alternative, continued deferral of both recognition of current costs and initiation of corrective measures to rectify any past unrecovered costs, will require much larger adjustments to be made at some future date.* 83 F.C.C. 2d at 293, emphasis added.

In overriding the strenuous objections of state commissions expressed in docket 20188, the Commission, as stated in the language just quoted, *put aside the past practice* of "continued deferral" of cost recognition and corrective measures. In its place, the Commission adopted new depreciation policies discharging its statutory mandate to assure adequate facilities by maintaining the financial integrity of telephone companies and to protect consumers from the risk of having to bear the cost of depreciation shortfalls.

There can be no question that the Commission's decision gave careful consideration to the impact of new depreciation levels on interstate and intrastate ratepayers. In fact, the "excessive conservatism" of regulatory commissions in refusing to permit realistic depreciation levels because of the impact on rates was specifically noted by the Commission. *See Primer and Overview of Depreciation and Capital Accounting,* Prepared by the Chief, Accounting & Audits Division, August 8, 1980, page 26, issued by the Commission in support of its Report and Order. The Commission stressed that:

> [I]t is necessary that accounting and depreciation rules not stifle innovation and inhibit the introduction of new technology. . . . The seeming attraction of stretching out lives to hold down depreciation expenses may impose longer-term costs on our society that far outweigh the short-term advantages. Although our decision to permit SLELG [or remaining life] is likely to result in an increase in the near term in revenue requirements, we believe that the relative size of the increment will be repaid many times over in future years as the ability of regulated telephone companies to continue to provide '. . . rapid, efficient . . . communication service with adequate facilities at reasonable charges ['] is enhanced. 83 F.C.C. 2d at 281.

The Commission's decision in Docket 20188 was clear and emphatic, carrying out its congressional mandate while recognizing the need for consequent subscriber rate increases under both federal and state regulation.[12] The FCC adopted its depreciation policies by unanimous Commissioner vote after long and careful study, taking all relevant factors into consideration. These policies must be recognized at the outset as the kind of matter referred to in Paragraph 37 of the Order—"policies or rules we have adopted to carry out statutory objectives"; "federal policies or rules" with which state regulation must be reconcilable; and "important interests of national communications policy" which must not be imperiled by state action, including state ratemaking action.

The Order contains language concerning depreciation, not reflecting the Commission's intent, which is at odds with those principles set out in the order itself.

The analysis in Part II of the Order leads to the conclusion that "federal regulation will not be frustrated if carriers maintain additional records for intrastate ratemaking purposes" (¶ 37). While we would challenge the reading of statutory provisions and history at a number of points in the course of the Part II discussion, the essential conclusion just quoted is not an issue in this proceeding insofar as the Joint Petitioners are concerned.

No exhaustive review of legislative history is necessary to support the conclusion that states may require the generation of additional records for intrastate ratemaking purposes, if such action does not conflict with FCC policies. This point is established by the words of § 220(a) of the Act, which makes the FCC's prescription of accounting requirements a matter of FCC discretion. So long as the Commission does not exercise that discretion to prescribe accounting requirements on an exclusive and preemptive basis, clearly the states may continue their long-standing practice, in compliance with their own statutes, of

[12] The pleadings of various state commissions objecting to ELG and remaining life cited the consequent increases in intrastate rates as a reason for the FCC to reject these industry proposals. These filings would have been meaningless if the states did not recognize the power of the FCC to make these methodologies applicable for all purposes.

requiring the generation and production of additional records for purposes of their own regulatory functions, including ratemaking.

The point of serious concern in the Order, in terms of those "important interests of national communications policy" identified by the Commission in Docket 20188, is reflected in the following language of Paragraph 8 of the Decision:

> We have concluded, for reasons explained in Part II, that Section 220 does not preclude state commissions from departing from accounting or depreciation rules prescribed by this Commission for purposes of regulating intrastate telecommunication service rates.

The foregoing sentence can be read to open the door to action by state commissions far beyond merely requiring additional records. The quoted Paragraph 8 sentence (with related language in Paragraphs 3, 7 and 8), is being interpreted to allow *any* action of "state commissions . . . departing from accounting or depreciation rules prescribed by this Commission for purposes of regulating interstate telecommunication service rates."

The sweep of the quoted language of Paragraph 8 is far broader than the Commission could have intended. It embraces not only § 220(a) matters, where discretionary FCC powers are involved, but also § 220(b) matters, where the Commission operates under a statutory mandate to issue prescriptions. Such a broad sweep of language is unsupported by the discussion in Part II of the Order, which merely deals with the state power to require additional records. And it is in direct conflict with the language of Paragraph 37 of the Order, and the emphatic assurances given to the Commissioners in open meeting on April 1 that the Order would in no way undercut the Commission's ability to preempt inappropriate state action. It is clear that the Commission did not intend to strip itself of the power to give effect in the real world to those policies regarding depreciation, and related accounting issues, addressed in Docket 20188. But the Paragraph 8 language issues a confusing signal likely to be misinterpreted and to undermine FCC policies.

Paragraph 37 sets out the governing principles applicable to any exercise of federal preemptive power. State regulatory actions

that might interfere with, or tend to frustrate, policies or rules that the FCC has adopted to carry out statutory objectives with respect to interstate and foreign communications will be preempted. Where such circumstances arise, the FCC will override state agency actions, unless state regulation is reconcilable with federal policies and rules. Most importantly, state regulatory action, including state ratemaking action, will be foreclosed where those actions imperil "important interests of national communications policy". All of these sound principles are set out with ample supporting case law in the Order itself.[13]

The intention of the Commission, as expressed in Paragraph 37 and in numerous Commission pronouncements, is that critical national policy decisions of the FCC will not be negated by state action. It is clear that Commissioners and Staff at the April 1st meeting had this understanding of the matter. But as it emerged in the Order, most of all in Paragraph 8, and as it is being viewed at the state level, the impact of the Order is to undercut implementation of FCC depreciation policies.

The Ohio case requires FCC action clarifying the Order and applying the Commission's policies.

General Telephone Company of Ohio, one of the GTE telephone companies, is concurrently submitting to this Commission a Petition for Declaratory Ruling which will address the clear conflict between depreciation prescriptions issued, on the one hand, by this Commission,[14] and, on the other hand, by the Public Utility Commission of Ohio. As reflected in the GTE Ohio company's petition, there is a differential between federal and

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[13] The Order expresses each of these thoughts in double negatives rather than clear affirmatives. But there can be no challenge to the correctness of the formulation set out above, as recognized time and again by the Commission and the courts. Here, in fact, Congress' "statutory objective" in 1934 leaves the FCC with no choice but preemption. For a clearer and more definite statement of the FCC's preemptive power, *see* Brief for the FCC dated December 30, 1981, in the D.C. Circuit appeal of Docket 20828, page 68, et seq.

[14] *See* Order released January 28, 1982, FCC 82-40, and Order released February 3, 1982, FCC 82-53.

state prescriptions exceeding $7 million in depreciation charges for the first year of rate implementation. Not only does this mean that our Ohio company will not realize timely capital recovery, as the FCC intended in adopting its Docket 20188 policies and in issuing its prescriptive decisions under § 220(b) of the Act; it could mean that the Ohio company, caught between federal and state sovereigns, may be denied full recovery of invested capital. Either of these results would frustrate the Commission's policies adopted to implement its statutory mandate, and would violate the basic principles of equity and fairness which have governed federal/state regulation of carriers involved in providing both interstate and intrastate service.[15]

As a practical matter, the same piece of property cannot be depreciated successfully at two different rates. Under modern accounting methods, units of equipment are placed in groups. The costs represented by these groups are then allocated between interstate and intrastate jurisdictions. These allocations may change month to month, depending on measured jurisdictional use of the property in question. Given these circumstances, it is virtually inevitable that capital will be recovered more slowly or more quickly than one rate or the other calls for. If the intrastate ratepayer contributes too much, the interstate customer will give too little, and *vice versa*.

This impossibility of successful depreciation—that is, recovery of exactly the capital invested except by sheer coincidence—suggests that dual depreciation rates are not feasible and that a single rate should be used. If the commission believes that the rates it approves, based on carefully-developed federal policies and rules, should be the prevailing ones, it has the legal power to accomplish this.[16]

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[15] *See Smith v. Illinois Bell Tel. Co.*, 282 U.S. 133 (1930).

[16] In the *North Carolina* cases cited in ¶ 37 of the Reconsideration Order, and in the *Computer II* decision of the FCC, 84 F.C.C.2d 50, 104, the essential indivisibility of the interstate and intrastate uses of telephone equipment was crucial to the legal outcome. Similarly here, despite the artificial attribution of property to intrastate and interstate

The Ohio case provides a specific example of direct federal/state conflict imperiling FCC policy objectives in the area of depreciation. The state commissions, when they strenuously opposed FCC action adopting ELG in Docket 20188, recognized the federal power. Now the Order is being interpreted to signal the withdrawal of federal power—and yet a close reading shows that this was not the Commission's intent at all. The Order must be reexamined and clarified to make certain that there is no misapprehension of the power and will of this Commission to make certain its depreciation policies are given real effect—which must mean capital recovery actually effected on a timely basis.

The Part II discussion will create serious problems in terms of future Commission action.

While the discussion in Part II of the Order leads merely to the conclusion that the states may require additional records, and even this conclusion is limited to the subject matter of this proceeding ("in this instance"), it contains many phrases and allusions that will create serious problems for the Commission in implementing its policies.

The Order says (¶ 34) that GTE is "asking us to repudiate nearly forty years of administrative practice;" but the Order does not recognize that the Commission has itself dramatically changed its practices and policies. For example, in the mid-1970s, the Commission concluded that the procedures previously applied to the GTE telephone companies, where "no objection" letters were issued, should be replaced by the issuance of formal FCC prescriptions under Section 220(b)—in order to bring FCC practice into closer conformity with the intent of Congress.

Docket 20188 also recognized the inadequacy of what had occurred in those previous years. As set out in the earlier discussion of Docket 20188, the Commission decided that there should *not* be "continued deferral" of cost recognition and corrective measures; rejected the "seeming attraction of stretching out lives to hold down depreciation expenses;" and emphasized that appropriate and timely increases in depreciation charges would be

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jurisdictions, depreciation necessarily is a unitary process. The property cannot be divided successfully.

"repaid many times over in future years."[17] Thus, it was the FCC itself that charted a clear new direction—but the Order never refers to Docket 20188 at all. Part II treats superseded practices respectfully, while ignoring the Commission's current policy, expressly designed to remedy the failings of those practices.

All of these elements, and more, of the Part II discussion will represent obstacles to Commission action in the future. In terms of Docket 20188 and depreciation prescriptions thereunder, this is already demonstrated by the Petition of General Telephone Company of Ohio. When the Commission decides to make certain that our Ohio company is able to effect capital recovery under FCC prescriptions, the unfortunate wording of the Order will be brought up to frustrate Commission action.

For example, if the matter reaches Federal Court, the Commission itself will be hard pressed to explain why the 1965 *P.T. & T.* case, discussed in Paragraph 33 with evident approval and apparently referred to in Paragraph 34 as "applicable state court precedents",[18] would not justify the conclusion that a state commission "is not bound by the depreciation rates or methods set by the Federal Communications Commission." *See* 401 P.2d at 372-373, 58 P.U.R. 3d at 253-254.

In terms of implementing the Commission's CPE deregulation program, the present Order, if not clarified, will represent a serious obstacle. A critical set of options which the Commission has under study[19] is action setting net book value as a proxy for economic value of CPE, or using other valuation methods, and dealing with any depreciation shortfalls or overrecoveries. With an FCC decision recently issued apparently endorsing California and Florida commission actions refusing to be bound by FCC prescriptions under § 220(b)—which is the way the Order is being interpreted—the result will be elimination, in practical terms, of

[17] *See* 83 F.C.C.2d at 281.

[18] No other state court decision is cited. A 1966 Florida Commission decision is referred to in Footnote 20 of the Order.

[19] *See* Notice of Inquiry in CC Docket 81-893, particularly Paragraphs 8-13 and 19-23.

FCC power to implement these options. This is another example of how the Part II descussion can be expected to obstruct FCC policies.

As to non-fully subject carriers, Part II of the Order is an obstacle to application of FCC preemptive power—also contemplated in CC Docket 81-893. If state commissions in California and Florida are not bound by FCC depreciation decisions as to fully subject carriers, as Part II of the Order implies, on what theory could it be maintained that non-fully subject carriers are bound?

By its terms, Section 220 applies to "carriers subject to this Act." If the Commissioner were to determine that the federal interest justified similar treatment for non-subject carriers, it would be well advised to base any required ancillary jurisdiction on the firmest possible statutory foundation.[20]

The Commission should reexamine Part II entirely,[21] to see whether, apart from its technical infirmities, it does not represent a serious block to implementation of the Commission's own policies.

We suggest certain clarifying language.

In order to dispel confusion and uncertainty as to FCC power and intent, we respectfully suggest the following specific changes in the Order:

1. CLARIFICATION OF PARAGRAPH 37.

The statement of principles set out in Paragraph 37 of the Order should be expressed in clear affirmatives rather than double negatives, and the relationship with the Commission's Docket 20188 policies should be clearly stated. This would be merely a

[20] The Supreme Court struck down FCC imposition of access requirements on cable systems, subject only to ancillary jurisdiction, when the FCC could not impose such requirements on broadcasters, subject to direct jurisdiction. *See FCC v. Midwest Video Corporation*, 440 U.S. 689 (1979).

[21] *Attachment 1* addresses certain serious misreadings of legislative history reflected in Part II.

question of recasting three sentences in Paragraph 37 to read something like the following:

- *State regulatory actions, including state ratemaking, that might interfere with or tend to frustrate the policies adopted by the FCC in Docket 20188 to carry out the statutory objectives set out in Section 220, Title II, and the entire Act, will be preempted.*
- *Where state regulation is not reconcilable with such policies, the FCC will override state agency actions.*
- *Congress intended this Commission to foreclose state regulatory action, including state ratemaking action, where any such action imperils the important interests of national communications policy established by the Commission in Docket 20188 in respect of depreciation and depreciation-related accounting matters.*

2. CLARIFCATION OF PARAGRAPH 8.

Paragraph 8 (with related language in Paragraphs 3 and 7) should be modified to make it clear that there is no intent, by virtue of the Order, to open the door to state commission action beyond simply requiring additional records. In other words, the scope of the language in Paragraph 8 should not be broader than the supporting discussion in Part II of the Order—and that leads only to allowing state commissions to require additional records. As an example, we suggest the following concluding sentence in Paragraph 8:

> *We have concluded, for reasons explained in Part II, that Section 220 does not preclude state requirements for the maintenance of additional records, so long as there is no conflict with any prescription of this Commission issued on an exclusive and preemptive basis.*

3. CLARIFICATION OF PART II.

Part II should be completely reexamined in light of FCC policy objectives. Most of all, Paragraphs 33 and 34 of the Order should be modified by explicit reference to the restated principles of Paragraph 37.

We suggest that these clarifications should accomplish the following Commission purposes.

Clarification of the Order, as suggested, should be designed to accomplish the following Commission purposes:

> *First,* explicit recognition that the Commission's decision not to preempt the states as to station connection expensing does not constitute abandonment of the Commission's "important interests of national communications policy" expressed in CC Docket 79-105 and Docket 20188, but was predicated on the understanding that these "important interests," as they relate to station connection expensing, would be substantially achieved in that case—under the descretion allowed by § 220(a)—without the necessity for preemptive action.
>
> *Second,* explicit recognition that the FCC's policies concerning depreciation, and depreciation-related matters, as set forth in Docket 20188, are matters coming within the phrases used in Paragraph 37 of the Order—as "policies or rules [the FCC has] adopted to carry out statutory objectives"; "federal policies or rules" with which state regulation must be reconciled; and a statement of "important interests of national communications policy" which must not be imperiled by state action, including "state ratemaking actions."
>
> *Third,* explicit recognition that FCC action under § 220(b) prescribing depreciation methodologies and rates is binding on carriers and state commissions.

CONCLUSION

We urge the Commission to clarify the Order, in the public interest, as set out in the preceding paragraphs.

Respectfully submitted,

By /s/ Thomas Jones (gp)
Thomas L. Jones
1800 K Street, N.W.
Suite 629
Washington, DC 20006
(202) 466-2895
Attorney for Continental Telecom Inc.

By /s/ Richard McKenna (gp)
Richard McKenna
One Stamford Forum
Stamford, CT 06904
(203) 965-3078
Attorney for GTE Service Corporation and its affiliated domestic telephome companies

By /s/ Hayward Fisk (gp)
Hayward D. Fisk
1875 Eye Street, N.W.
Suite 1250
Washington, DC 20006
(202) 659-4600
Attorney for United Telephone System, Inc.

June 7, 1982
(Filed June 8, 1982)

ATTACHMENT 1

*In 1934, the House Report explicitly recognized that the NARUC-sponsored version of ¶ 220(j) represented a change from the Interstate Commerce Act.**

Part II of the Order errs in concluding that the 1934 Congress which adopted the new Communications Act "was completely silent as to its intent" in eliminating the House version of § 220(j) sponsored by NARUC; and that, at most, the silence could merely be construed to mean that the lawmakers "did not choose to resolve the question at that time." (¶¶ 27 and 29)

In fact, Congress was not silent. In the Report of the House Committee, which accepted the urging of the states that they not be limited in prescribing their own percentage depreciation rates for intrastate property, the pertinent amendments were said to be

> responsive to the requests of the State Commissions *that the present law be changed* so as to permit those bodies to exercise, for State purposes, certain jurisdiction over accounting systems and methods of depreciation accounting.[1] (Emphasis added.)

Thus, Congress understood that a change in the law was being recommended. By rejecting the House-proposed change sponsored by NARUC, as it did, the Conference on the 1934 legislation was deciding in favor of existing law.

The Interstate Commerce Commission and the courts had concluded that preemptive, prescriptive power over depreciation was granted by the Interstate Commerce Act.

Contrary to Part II of the Order, which purports to find only silence (¶¶ 17-20), both the Interstate Commerce Commission (ICC) and the courts were explicit in their views of the pertinent section of the Interstate Commerce Act (ICA).

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* See also pages 4-13 of the GTE Companies' Opposition to Petitions for Clarification and Reconsideration, June 11, 1981.

[1] H. Rep. No. 1850, 73d Congress, 2d Session, p. 7.

The antecedent of § 220(b) was § 20(5) of the ICA, as it stood after a 1920 amendment.[2] Section 20(5) was not amended between 1920 and 1934. Its wording was imported, with only inconsequential changes, into § 220 of the Communications Act of 1934. Thus, what the ICC and the courts said about federal depreciation authority during the period, 1920-34, when the ICC was assigned the chief responsibility for federal telephone regulation, is highly pertinent to the meaning of § 220.

In 1926 the ICC released its decision in *Depreciation Charges of Telephone Companies* (No. 14700), 118 I.C.C. 295 (1926), which concluded in part:

> "Telephone property, although used largely for local business, is subject to federal regulation when its is subject to interstate use." 118 I.C.C. at 296.

The ICC report embodying the decision went on to explain:

> It seems to be well established that where a local telephone company undertakes to originate or deliver toll messages, and most of them do so undertake, practically all of its property is open for use in interstate commerce and at any time may be so used. 118 I.C.C. at 332.

Thus, there could be no question of Congress' power to order uniformity in depreciation of interstate-use property. And, the report continued, the ICA evidenced Congressional intent to delegate such power to the ICC:

> Unless and until the provisions of paragraph (5) of Section 20 are changed by Congress, therefore, we feel that we must endeavor to enforce them in the case of such companies. 118 I.C.C. at 333.

"Such companies" referred to Class A, B and C companies for whom uniform accounting already had been prescribed, categorized according to annual operating revenues. Class D companies with revenues of less than $50,000 had been "exempted from our

[2] That provision, virtually unaltered, may now be found at 49 U.S.C. § 20(4).

accounting regulations, even though engaged to some extent in interstate commerce." 118 I.C.C. at 332

Accordingly, even for these smallest companies, the question was not one of ICC jurisdiction. Plainly, according to the 1926 decision, Congress intended, and the ICA conveyed, agency power over accounting and depreciation of all telephone companies. While the ICC, in its discretion, could allow the states to prescribe, it was clear that *if the federal power were exercised*, inconsistent state actions would be preempted. *See* 118 I.C.C. at 332.

In fact, the ICC chose to enlist the aid of the states, where possible, in accepting, reviewing and holding hearings upon telephone company depreciation proposals. The federal agency was very careful to use words indicating that the state commissions were simply helping, and were not supplanting federal jurisdiction. *See* 118 I.C.C. at 374-376. As it happened, the ICC never did issue a final order of direct federal prescription in the matter of telephone depreciation. Thus, in the absence of a federal *exercise* of depreciation-prescription power, the states were left free to act.[3] But the agency already had declared, in 1926, the power to preempt when it did prescribe, and no court rejected that view of the law.

Another indication of the view of the ICC of its powers under the ICA was contained in a letter of the then-Chairman of the ICC (referred to in the Order, footnote 15), which stated, with reference to the NARUC-sponsored version of § 220(j) ultimately rejected by Congress:

> Paragraph (j) . . . should be most carefully considered. It unquestionably directly conflicts with, and destroys the uniformity of systems of accounts and depreciation accounting required by the preceding provisions of the section. *That is not true under the present law.*[4]

[3] *Northwestern Bell Telephone Co. v. Nebraska State Ry. Commission*, 297 US 471 (1936).

[4] Letter printed in the March, 1934, Hearings, before the Committee on Interstate Commerce, 73d Congress, 2d Session, at page 208.

The intent of the 1934 Congress is clear; it must be carried out by the Commission.

As noted, when Congress acted in 1934, it recognized that the NARUC-sponsored version of § 220(j) represented a change from the depreciation-related provisions of the ICA. Not only is this reflected in ICC and court action; the Chairman of the ICC expressly made this point to Congress in questioning the appropriateness of NARUC's proposal, since it would directly conflict with, and destroy, uniformity of systems of accounts and depreciation accounting *"required by the preceding provisions of the section"* [*i.e.*, of § 220].

That Congress knew what it was doing in 1934 is clearly indicated in the words of the statute and its reports. This is demonstrated by the foregoing discussion, and further evidenced by looking at what Congress was doing with other regulatory statutes of same era. Congress knew how to provide for the states a reservation of jurisdictional power over depreciation. This was done in the Federal Power Act passed in 1935 and in the National Gas Act passed in 1938, where language similar to NARUC's § 220(j) was included.[5] Neither the 1934 Congress, nor any of the subsequent Congresses, chose to adopt the language which NARUC would have this Commission read into the Act.

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[5] *See* 16 U.S.C. § 825a(a) (August 26, 1935); and 15 U.S.C. § 717h(a) (June 21, 1938).

Nos. 84-871, 84-889, 84-1054 and 84-1069

IN THE

Supreme Court of the United States

October Term, 1985

LOUISIANA PUBLIC SERVICE COMMISSION,
Appellant

v.

FEDERAL COMMUNICATIONS COMMISSION and
UNITED STATES OF AMERICA, et al.,
Appellees

(and three consolidated cases)

ON APPEAL FROM, AND ON WRITS OF CERTIORARI TO, THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

BRIEF FOR GTE SERVICE CORP. AND AFFILIATED TELEPHONE COMPANIES, APPELLEES-RESPONDENTS

WILLIAM R. MALONE
One Stamford Forum
Stamford, Ct. 06904-9500
(203) 965-2231

Counsel for GTE Service Corporation and its affiliated domestic telephone operating companies

Of Counsel:

RICHARD MCKENNA*
One Stamford Forum
Stamford, Ct. 06904-9500

JAMES R. HOBSON
1850 M Street, N.W., Suite 1200
Washington, D.C. 20036

PHILIP A. LACOVARA
Hughes Hubbard & Reed
1201 Pennsylvania Avenue, N.W.
Washington, D.C. 20004

November, 1985

*Counsel of Record

QUESTIONS PRESENTED

1. Did the Federal Communications Commission reasonably interpret Section 220(b) of the Communications Act as automatically making FCC depreciation methods and rates binding on the State regulatory commissions when prescribed for telephone plant that is jointly used for both interstate and intrastate communication?

2. Did the FCC reasonably decide to preempt inconsistent State regulation of depreciation of jointly used plant, once the FCC had determined that it would frustrate Federal responsibility for the integrated national communications network to allow the States to order telephone companies to use different methods and rates for depreciating plant subject to FCC regulatory authority?

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Preliminary Statement

This brief is submitted on behalf of GTE Service Corporation and its affiliated domestic telephone operating companies (herein "GTE"),[1] which intervened as of right in support of the Appellee-Respondent Federal Communications Commission in the court below.

The Fourth Circuit upheld the FCC's decision that, under the Communications Act of 1934, the depreciation rates and methods prescribed by the FCC preempt inconsistent depreciation orders

1. GTE Service Corporation and its affiliated domestic telephone operating companies are wholly-owned subsidiaries of GTE Corporation. In compliance with the Court's Rule 28.1, a current list of principal subsidiaries of GTE Corporation is contained in Appendix IV to this brief. A more complete list of all subsidiaries of GTE is being filed with the Clerk.

of the States. *Virginia State Corp. Com'n.* v. *FCC*, 737 F.2d 388 (4th Cir. 1984), *aff'g Amendment of Part 31*, 92 F.C.C.2d 864 (1983) (*1983 Preemption Order*).[2] This Court should affirm the decision of the court below.

GTE adopts in all respects the consolidated brief filed jointly by American Telephone and Telegraph Company (AT&T) and certain other telephone company intervenors supporting the Commission. The instant brief is submitted to supplement the facts and legal analysis contained in the consolidated brief.

STATEMENT OF FACTS

GTE, as the nation's largest Independent (non-Bell) telephone company, participated from the outset in efforts to secure FCC sanction for modern capital recovery mechanisms for carriers. After the Commission approved the equal life grouping (ELG) and remaining life methods of depreciation in 1980 (J.A. 4) and 1981 (J.A. 45), the carriers encountered resistance to the use of these methods at the State commissions.[3] The GTE companies were among the carriers filing petitions for reconsideration of the FCC's April 27, 1982, order, which had held 3-2 that the Commission's prescriptions were not preemptive (A-61). These petitions resulted in the Commission's unanimous adoption of the *1983 Prescription Order* (A-24).

One of the GTE companies, General Telephone Company of Ohio ("GTC of Ohio"), also filed with the Commission on June 7, 1982, a petition for a declaratory ruling that the FCC's antecedent orders[4] prescribing rates and methods of depreciation for GTC of Ohio over the objections of the Ohio PUC, preempted the PUCO's subsequent opinion and order in GTC of Ohio's pending

2. The Fourth Circuit's opinion is printed in the appendices in Nos. 84-871, 84-889, and 84-1054 at A-1. The FCC's decision is printed in the appendices in Nos. 84-871 and 84-1054 at A-24 and in No. 84-889 at A-55.

Page references in this brief, shown as "A-1", "A-2", etc., are to the Louisiana Appendix (No. 84-871). This paging also corresponds to that of the Ohio Appendix (No. 84-1054) for those documents therein contained. Page references to the joint appendix filed in this Court are prefixed "J.A."

3. *1983 Prescription Order*, 92 F.C.C.2d at 877 (A-46).

4. General Tel. Co., 88 F.C.C.2d 1354 (Jan. 28, 1982) (remaining life); *same*, 88 F.C.C.2d 1567 (Feb. 3, 1982)(ELG).

rate case,[5] which rejected such rates and methods.[6] The preemptive declaration sought in the GTC of Ohio petition was granted by the *1983 Prescription Order*, 92 F.C.C.2d at 880 (A-50).

The FCC, in so ruling, noted that the record indicated a differential for GTC of Ohio of seven million dollars a year between depreciation levels prescribed by the FCC and those established by the Ohio Public Utilities Commission. *1983 Preemption Order*, 92 F.C.C.2d at 878-879 (A-48-49). As exemplified by this seven million dollar figure, the consequences of such inconsistencies in the absence of FCC preemption, can place serious risks on the firm caught between the two sovereigns.[7]

The record before the FCC showed that the imposition of inconsistent rates and methods of depreciation would block complete capital recovery by the carriers. Use of different depreciation methodologies and rates for interstate and intrastate purposes would mean that *the same item of plant* would be depreciated differently (that is, treated financially as having different lives) for interstate and intrastate service, so that a portion of the plant investment might remain on the books for State purposes when it had been fully depreciated for FCC purposes, or vice versa, leaving "stranded investment" in the rate base in perpetuity. Further, the record showed that only "sheer and remote chance" would produce consistent figures in interstate and intrastate plant accounts for any particular period, so that there could be no assurance aggregate revenues generated under Federal and State regulation would cover these varying depreciation accruals. *See* GTC of Ohio petition at J.A. 93-94 and 119-21; Joint Petition for Clarification at J.A. 134-35.

5. GTC of Ohio's petition is printed in the joint appendix at J.A. 89 - 121. Pertinent excerpts from the Ohio PUC's order of April 26, 1982, appear at J.A. 106 - 114 as Exhibit A to the GTC of Ohio petition. (The purported page heading at J.A. 106 is a departure from the record by the printer, and it should be disregarded.) The PUCO's order on rehearing, the pendency of which was noted in the FCC's *1983 Prescription Order* at ¶ 43 (A-49), is published at 49 P.U.R.4th 114 (1982).

6. *1983 Prescription Order*, ¶¶ 41-43, 92 F.C.C.2d at 878-79 (A-48-49). The GTC of Ohio petition is adverted to in the opinion below, 737 F.2d at 391 & n. 6 (A-8).

7. Commissioner Fogarty termed "alarming" the annual discrepancy between GTC of Ohio's allowed depreciation under Federal and State rules. 92 F.C.C.2d at 884 (A-60).

The FCC concluded on the basis of the record that the resulting "improper capital recovery ... could, ultimately, threaten carriers' ability to fully recover their invested capital." *1983 Preemption Order*, 92 F.C.C.2d at 877 (A-46). The failure to recapture capital investment on a realistically prompt basis would in turn, the FCC found, retard technological innovation beneficial to the integrated interstate telecommunications network and would give unregulated competitors an unwarranted advantage over the regulated telephone companies. *Id.*

SUMMARY OF ARGUMENT

The FCC properly concluded that, under the Communications Act of 1934, the Federal commission's prescriptions of depreciation rates and methods are binding on the carriers and the State commissions. Inconsistent determinations by the States as to depreciation are preempted by force of law.

I.

A. In structuring the 1934 Act as a whole, Congress faced up to the conflict between Federal and State jurisdiction inherent in regulating property used both for interstate and intrastate services, and it resolved the potential conflict in favor of preemptive Federal authority.

B. With respect to depreciation the Commission properly construed the language of Section 220(b) of the 1934 Act to require the carriers to adhere to FCC prescriptions and the State utility commissions to recognize these prescriptions, unless specifically excepted by the Commission under Section 220(h). Analysis of the text of Section 220 compels this result. Moreover, the legislative history of Section 220 shows that Congress consciously chose to confer preemptive power on the new FCC with regard to depreciation. The Interstate Commerce Commission, the FCC's predecessor, indisputably had preemptive power over telephone depreciation. President Roosevelt urged that the ICC's powers be transferred to the new Communications commission, and Congress ultimately did so. In the course of the legislative process the National Association of Regulatory Utility Commissioners (NARUC), on behalf of the States, had proposed bill language to insulate State jurisdiction against continuation of the ICC's preemptive power. That language was included in the companion bills introduced in both houses of Congress in the 73d Congress. NARUC-sponsored language designed to change the law by constricting the FCC's jurisdiction over depreciation was consciously rejected by the Senate and did not survive conference.

C. The intrastate exemptions under Section 2(b) of the Act do not limit the preemptive effect of Federal prescriptions under Section 220. By itself Section 2(b) at most preserves State authority over purely intrastate rates and purely intrastate facilities. But this case involves interstate carriers over whom the FCC has explicit jurisdiction, and it involves property used in interstate (as well as intrastate) communication. As Section 220(i) reflects, Congress chose to accommodate the State interest in such "dual jurisdiction" property by directing the FCC merely to *consult* with the State commissions, but it did not require the FCC to *defer* to them.

Textually, Section 2(b)(1) is but a paraphrase of the language of Section 1 of the Interstate Commerce Act. Just as that language did not limit the plenary authority of the ICC with respect to depreciation under the predecessor language of Section 220(b), so Section 2(b)(1) does not limit the FCC's plenary authority under Section 220(b). Section 2(b)(1)'s legislative history shows that at most it was intended to reverse the *Shreveport* doctrine,[8] thereby barring Federal prescription of intrastate rates. The FCC's action below, which does not amount to a prescription of intrastate rates, bears no resemblance to the ICC's action in *Shreveport*.

Depreciation has always been considered a special and separate matter, and hence the *Shreveport* reservation of Section 2(b)(1) is not at issue here. Since Section 220 gives the FCC the power to prescribe depreciation rates and methods specifically in paragraph (b) and contains its own intrastate exception in paragraph (h), such depreciation prescriptions are not within Section 2(b)(1)'s general prohibition against prescribing intrastate rates

8. In Houston, E. & W. Tex. Ry. v. U.S., 234 U.S. 342 (1914) (the *Shreveport* case), the Court held that the intrastate proviso in Section 1 of the Commerce Act did not prevent the ICC from directly ordering intrastate rates raised in order to eliminate discrimination against interstate commerce.

themselves. If the language of Section 2(b)(1) had been conceived as extending to foreclosure of Federal preemption of depreciation, NARUC would not have found it necessary in 1934 also to propose -- unsuccessfully -- the addition to Section 220 of a proposed paragraph (j)(1), which would have separately exempted State depreciation orders from FCC authority.

II.

The FCC properly declared its prescription of rates and methods of depreciation to be preemptive of inconsistent State orders.

A. Congress clearly contemplated that the FCC, no less than the ICC, should have plenary power over depreciation systems in the interest of uniformity. The FCC's interpretation of Section 220, giving its prescriptions preemptive effect, should be sustained by the Court as being within Congress' intent.

B. Although the FCC had not previously found it necessary to make its depreciation orders preemptive, it did not thereby forfeit the power to do so under Section 220 when circumstances warranted. Neither the 1934 Act nor its predecessor, the Esch-Cummings Act of 1920, contemplated instantaneous Federal occupancy of the field of depreciation. Practice under the ICC and the FCC, validated by this Court in *Smith* v. *Illinois Bell Tel. Co.*, 282 U.S. 133, 159-60 (1930), and *Northwestern Bell Tel. Co.* v. *Nebraska State Ry. Com'n.*, 297 U.S. 471, 478 (1936), permitted State regulation of depreciation to exist until displaced by Federal prescription. The FCC's practice of holding "three-way meetings" on depreciation with the State and the carrier is wholly consistent with Section 220(i), which authorizes the FCC to "consult" with the States but does not require it to accede to non-uniform systems of depreciation. The FCC's deferral of its preemptive declaration until it became apparent that non-conformity by the States was becoming a significant problem was an appropriate exercise of Federal-State comity.

C. The FCC adequately explained why it determined no longer to allow carriers to depart from uniform Federal depreciation rates and methods. The Commission's determination in its *1983 Preemption Order* to invoke its preemptive powers under the 1934 Act was a reasonable one in light of current conditions in the

telephone industry. The introduction of competition into a heretofore monopolistic environment by the FCC, the Bell divestiture by the courts, and other developments rendered inadequate previous rates and methods of depreciation. The discrepancies between Federal and State depreciation rates and methods had become economically intolerable.

In Section 1 of the 1934 Act, Congress manifested its intent to centralize in the FCC authority to achieve its purposes. The Court should defer to the agency's expert judgment that inconsistent State depreciation orders would undermine important Federal policies.

ARGUMENT

I.

BY STATUTE THE FCC'S DEPRECIATION ORDER BINDS THE STATES.

The Federal Communications Commission properly concluded that, under the scheme of the Communications Act of 1934, the telephone companies for which the Commission has prescribed rates and methods of depreciation are obliged to adhere to such rates and methods, and the States are foreclosed by force of statute from imposing differing rates and methods on these companies.

Even if the Court, upon its own analysis of this complex regulatory statute and plan, were left with some uncertainty about precisely what Congress intended, this would be the classic kind of case in which to defer to the expert agency's careful and unanimous interpretation of the regulatory scheme that Congress has charged the FCC to administer. *See Chevron, Inc.* v. *NRDC*, 104 S.Ct. 2778, 2782 (1984); *Securities Industry Ass'n.* v. *Board of Governors*, 104 S.Ct. 3003, 3009 (1984); *Investment Co. Institute* v. *Camp*, 401 U.S. 617, 626-27 (1971); *Red Lion B/Cg. Co.* v. *FCC*, 395 U.S. 367, 381 (1969).

A. Congress Opted for Federal Regulation of Property Used Jointly for Interstate and Intrastate Communication.

In writing the 1934 Act, Congress faced up to the potential conflict between Federal and State jurisdiction inherent in regulating property used both for interstate and intrastate services, and it resolved the potential conflict in favor of ultimate Federal supremacy.

Congress, in considering the various communications bills in the early 1930's, realized that any viable statutory scheme would have to address the dual-jurisdictional nature of the domestic telephone industry.[9] Any satisfactory regulatory scheme would have to accommodate the facts that telephone lines and other ratebase property are used both for interstate and intrastate communication service and that, with the exception of AT&T itself, the same carriers provided both interstate and intrastate services.[10] The careful attention that was paid to this jurisdictional problem in the legislative process is manifest in numerous provisions of the Act accommodating in various ways the different Federal and State interests. *See, e.g.*, Sections 2(b), 208, 213(h), 214(b), 220(h)-(j), 221, 410.

There is no textual question but that Congress intended the 1934 Act to apply to property used in the provision of interstate communication service even if that same property were also used in the provision of intrastate communication service. The statutory scheme is readily apparent from the text of the Act.

Section 1 identifies among the national policies underlying the Act that of assuring, so far as possible, "to all the people of the

9. The ICC's telephone regulation following the Mann-Elkins Act of 1910 had been relatively unobtrusive. As discussed more fully at pp. 17-18, *infra*, a 1929 Senate proposal to strengthen Federal regulation of the communications industry had sparked strong State reaction, suggesting that passage of the communications legislation might prove to be politically dependent on a more fine-grained accommodation of State interests.

10. In Smith v. Illinois Bell Tel. Co., 282 U.S. 133, 150-51 (1930), this Court had already decided that, because local plant is used for interstate calls, an appropriate percentage of local plant costs should be placed within the jurisdiction of Federal rather than State regulators. Currently that proportion is about twenty-five percent of non-traffic-sensitive plant. *See 1983 Preemption Order*, 92 F.C.C.2d at 877 (A-45).

United States" adequate and universal telephone service at reasonable rates.[11] To achieve the purposes of the Act, Congress centralized in the new commission existing and additional authority "to execute and enforce the provisions of this Act." 47 U.S.C. § 151 (App. I at I-4).

Section 2(a) then provides that the Act "*shall apply* to *all* interstate and foreign communication by wire or radio ... and to *all* persons engaged ... in such communication..." (App.I at I-4-5) (emphasis supplied). The Act literally applies to *all* interstate communication, as carefully defined in Section 3(e), without exception.

Without limiting that statutory reach in the slightest, Section 2(b)(1) cautions that the Act does not apply to charges and other tariffable features that are used exclusively "for or in connection with intrastate communication service" provided by any carrier. The Act does not define "intrastate communication," because it is no more than that part of "communication" (defined in Section 3[(a), (b)]) which falls outside of "interstate communication," as defined in Section 3(e). Thus, Section 2(b)(1) does not purport to *withdraw* any part of the comprehensive authority given the FCC by Section 2(a) over all persons and facilities involved in providing interstate communications. It simply acknowledges State responsibility for purely intrastate facilities and services not treated as part of the "interstate" network. Conceptually, therefore, the permissible regulatory jurisdiction of the States is purely residual; the States possess autonomy in the regulation of carriers and "dual jurisdiction" telephone facilities only to the limited extent that Congress chose not to displace existing State authority. That limited residual authority in the States, however, does not include any Congressionally delegated power over property used jointly for intrastate and interstate communications which might be construed as an implied limitation on the authority expressly conferred upon the Commission.

11. The U.S. Court of Appeals for the District of Columbia Circuit relied on the quoted phrase in rejecting the contention that the FCC could not act to benefit intrastate service. NARUC v. FCC, 237 U.S.App.D.C. 390, 403 n. 6, 737 F.2d 1095, 1108 n. 6 (1984)(per curiam), *cert. denied*, 105 S.Ct. 1224 (1985); *cf.* Colorado v. U.S., 271 U.S. 153, 168 (1926).

Congress chose to accommodate the State interests in such dual jurisdiction property by authorizing the FCC to consult with the State commissions, but it did not require the FCC to defer to them. *See, e.g.*, Section 220(i) (accounts); Section 214(b) (certificates of public convenience and necessity); Section 221(c)(jurisdictional separations) and 410(a-c)(joint boards and cooperation with State commissions). Had Congress intended to withhold from the FCC jurisdiction over such property, such consultative provisions would have been either superfluous or contradictory.

If Congress in Section 2(b) had intended to fragment regulatory authority over property used for interstate communication -- including the property covered by the FCC orders in this case -- simply because that property is also used for intrastate communication, it knew how to manifest that intent. It would have described the power reserved to the States by using in Section 2(b)(1) -- as it did in Section 221(b) -- the language, "even though a portion of such ... service constitutes interstate or foreign communication...." *See North Carolina Util. Com'n.* v. *FCC*, 552 F.2d 1036, 1046 (4th Cir. 1977), *cert. denied*, 434 U.S. 874 (1977)(North Carolina II).[12]

Congress, however, did not crimp the FCC's overarching responsibility to deal comprehensively and authoritatively with all property used in interstate communication. Although the drafters carefully delineated the general scope of the Act to stay within the Commerce power, the virtually limitless reach of Congress' Constitutional power over carriers -- already marked out in the Court's *Shreveport* decision -- imposed no real constraint.

B. Section 220(b) Makes FCC Prescriptions of Depreciation Binding for All Carrier Property.

The Commission properly construed the language of Section 220(b) of the Act to require the carriers to adhere to FCC prescriptions of depreciation rates and methods. The legislative history of Section 220 clearly reveals that Congress consciously

12. Compare the explicit language from the 1934 amendments to the Federal Power Act and the 1938 Natural Gas Act, *infra* note 45, limiting Federal authority.

chose Federal supremacy for all depreciation and rejected State claims to unrestricted complementary authority.

1. *The Text of Section 220(b) Accords Preemptive Effect to FCC Prescriptions of Depreciation.*

Section 220 embodies a comprehensive and exclusive system for carrier accounts and charges relating to depreciation. Under Section 220(b) the depreciation rates and methods prescribed by the FCC presumptively preempt inconsistent State requirements, unless specifically excepted by the Commission under Section 220(h).

By Section 220(b) the Commission was mandated to classify depreciable property of the carriers subject to the Act and to prescribe depreciation rates for "each of such classes of property...." Section 220(b) further provides that the percentages of depreciation so prescribed "shall" be charged with respect thereto, and that "carriers shall not, ... after the Commission has prescribed percentages of depreciation, charge ... depreciation other than that prescribed ... by the Commission."[13] The language of Section 220(b) is clearly mandatory.[14] Once the FCC

13. Section 220(b) sets forth Congress' comprehensive scheme in these terms:

> The Commission *shall*, as soon as practicable, *prescribe* for such carriers the classes of property for which depreciation charges may be properly included under operating expenses, and the percentages of depreciation which shall be charged with respect to each of such classes of property, classifying the carriers as it may deem proper for this purpose. The Commission may, when it deems necessary, modify the classes and percentages so prescribed. Such carriers *shall not*, after the Commission has prescribed the classes of property for which depreciation charges may be included, charge to operating expenses any depreciation charges on classes of property other than those prescribed by the Commission, or, after the Commission has prescribed percentages of depreciation, charge with respect to *any* class of property a percentage of depreciation *other than* that prescribed therefor by the Commission. No such carrier shall *in any case* include in any form under its operating or other expenses *any* depreciation or other charge or expenditure included elsewhere as a depreciation charge or otherwise under its operating or other expenses. [emphasis added]

14. As we explain fully below, these provisions in the Communications Act were carried over from the amended Interstate Commerce Act, which had given the ICC responsibility to regulate telephone companies, including the power to prescribe depreciation rates. *See, e.g.*, Telephone and Railroad Depreciation Charges, 118 I.C.C. 295, 326

acts its decisions are binding, unless it makes an affirmative finding under Section 220(h) that allowing different State treatment would be "consistent with the public interest." Only in that limited circumstance after the FCC has acted may carriers follow inconsistent orders of the State commissions with respect to depreciation.

The States, however, deny the preemptive force of FCC depreciation decisions under Section 220(b) because, they claim, FCC-prescribed accounts promulgated under Section 220(a) do not bind them in intrastate ratemaking proceedings.[15] There are two basic flaws in this line of argument.

First, it is without textual support. Section 220(a) provides that the Commission "may, in its discretion, prescribe the forms of any and all accounts." Section 220(g) generally provides that, "after the Commission has prescribed the forms and manner of keeping of accounts..., it shall be unlawful ... to keep any other accounts ... than those so prescribed ... or to keep the accounts in any other manner than that prescribed or approved by the Commission."[16] In asserting that they are free to disregard the accounts prescribed by the FCC under Section 220(a), the States ignore Congress' deletion in 1934 of the NARUC-sponsored language from proposed Section 220(j)(2) of both the House and Senate bills that would have expressly preserved the authority of the States to obligate carriers to keep "any accounts, records, or memoranda which may be required to be kept by any State commission...."[17] *Cf. Kansas City So. Ry.* v. *U.S.*, 231 U.S. 423, 442 (1913)("Congress ... manifested a purpose to standardize and render uniform the accounts...."). While the FCC has sometimes *allowed* the States to require additional sub-accounts for

(1926). The ICC had relied on the mandatory nature of its depreciation prescriptions in Telephone and Railroad Depreciation Charges, 177 I.C.C. 351, 366-68 (1931).

15. Maine brief at 17-19; California brief at 6-7; Louisiana brief at 27-28; *cf.* FCC order, released April 27, 1982, at ¶¶ 32-35, 89 F.C.C.2d 1094, 1108 (A-61, A-82-83). The States' reliance on *PT&T Co.* v. *CPUC*, 62 Cal.2d 634, 666, 44 Cal. Rptr. 1, 401 P.2d 353, 372-73 (1965), is misplaced. The California court's opinion neither considers nor even mentions Federal authority under Section 220(b) over depreciation of dual jurisdiction property.

16. Section 220(g). Paragraphs (d) and (e) provide for civil and criminal penalties for failure to keep accounts as prescribed by the Commission.

17. California brief at 22-24.

purely intrastate ratemaking purposes, it is not at all clear that they would be entitled to do so, despite the apparently plain and preemptory terms of Sections 220(a) and (g), if the FCC did not approve or authorize these deviations under Subsection (g) or (h).

Second, the States' contention as to prescribed *accounts* simply misconceives the issue here. The *1983 Preemption Order* was limited to *depreciation* under Section 220(b). *Op. cit.*, 92 F.C.C.2d at 870, 873-74, 878 (A-33,-40,-48). The FCC was not required to decide, and did not decide, to what extent FCC-required accounting entries in general are binding on the states for ratemaking purposes. The Commission's powers as to accounting systems and as to depreciation systems are different and are separately stated in Section 220. Subsection (b) makes depreciation rates and methods prescribed by the Commission binding on the carriers and declares, with substantive effect, that no other depreciation charges with respect to carrier property are permissible. Subsections (a) and (g), on the other hand, relate to the general forms of accounts.[18] Pursuant thereto the FCC itself has recognized the substantive regulatory interests of the States in requiring additional or different information and has permitted "additional" or "subdivided" accounts.[19] Because of these differences in function and effect between accounting format and substantive depreciation prescriptions, agency practice as to accounting under Subsections (a) and (g) does not provide a guide to the construction of Subsection (b) governing depreciation.

2. *The Legislative History Confirms a Conscious Decision by Congress in Favor of Preemptability.*

The legislative history behind Section 220 unmistakably demonstrates that Congress consciously faced the preemption issue and consciously chose to allow FCC prescriptions of depreciation methods and rates to override inconsistent state orders.

The FCC inherited the preemptive power of the ICC with respect to depreciation. In his message to the first New Deal

18. *See* AT&T Co. v. U.S., 299 U.S. 232, 242-43 (1936).

19. *See, e.g.*, Uniform System of Accounts, 47 C.F.R. §§31.01-1(f), 31.01-2(d) and (f), and 33.12(d).

Congress, calling for centralization of "broad authority" over communications in a new Federal Communications Commission,[20] President Roosevelt urged that the ICC's telecommunications powers be transferred to the new commission and expanded. Section 1 of the 1934 Act makes clear Congress' general intent not only to transfer to the FCC the ICC's existing authority but also to "centralize" in the FCC even additional authority to serve as the primary agency with national responsibility to promote and regulate a modern, efficient, integrated telecommunications network.[21]

Congress adopted almost word-for-word the indisputably preemptive language of Section 20(5) of the Interstate Commerce Act[22] and rejected State commission attempts to add modifying language that would have permitted the State commissions to prescribe rates of depreciation in the exercise of their intrastate jurisdiction. Instead, Congress merely authorized the FCC "to investigate and report to Congress upon the desirability of legislation ... permitting State commissions to prescribe their own percentage rates of depreciation and systems of accounts for carriers."[23] The FCC never recommended conferring that authority on State commissions, and Congress has not done so.[24]

20. S. Doc. No. 144 (73d Cong., 2d Sess.) (Feb. 26, 1934); 78 Cong. Rec. 3272.

21. Section 1 (Purposes of Act, Creation of Federal Communications Commission) of the 1934 Act recites Congress' creation of the FCC to "execute and enforce" the Act's provisions "for the purpose of securing a more effective execution of [its] policy by centralizing authority heretofore granted by law to several agencies and by granting additional authority...." 47 U.S.C. § 151 (App. I at I-4).

22. The virtual identity of Section 20(5) of the Interstate Commerce Act, as amended by the Esch-Cummings Act of 1920, and Section 220(a),(b) of the Communications Act of 1934, is demonstrated by the side-by-side comparison in Appendix III, *infra*.

23. Statement of the House managers accompanying the conference report on S. 3285 (73d Cong., 2d Sess.), H.Rpt. 1918 at 47 (June 8, 1934); 78 Cong. Rec. 10987 (June 9, 1934).

24. In 1935 Congress adopted a resolution authorizing and directing the FCC to "investigate and report" on the telephone industry "in aid of legislation by the Congress...." In Section 2 of the resolution Congress directed that the Commission's investigation include a study of the accounting methods, "particularly with reference to depreciation accounting," etc., of both the fully subject and non-fully-subject companies. S.Jt.Res. 46 (74th Cong., 1st Sess.), Pub. Res. No. 8, 49 Stat. 43, ch. 31 (approved March 15, 1935). The Commission's report of its investigation, the so-called *Walker Report*, made no recommendations

a. The ICC Concededly Had Preemptive Power as to Depreciation.

All the parties involved in the drafting of the 1934 Act conceded that the Interstate Commerce Commission had preemptive power with respect to telephone company depreciation.

In *Telephone and Railroad Depreciation Charges*, 118 I.C.C. 295 (1926),[25] the ICC had dealt with the contention of the State commissions that the statute gave the ICC "discretion ... to refrain from prescribing depreciation requirements for the local telephone companies which in reality are engaged only to an insignificant extent in interstate commerce." The ICC held not only that it had jurisdiction to prescribe depreciation standards that would govern intrastate ratemaking but that it was obliged by the statute to do so insofar as practicable.[26]

for "legislation to define further or harmonize the powers of the Commission and of State commissions" with respect to depreciation. *See* Report of the Federal Communications Commission of the Investigation of the Telephone Industry in the United States, H. Doc. No. 340 (76th Cong., 1st Sess.) Part II (GPO 1939)(Walker Report).

25. This was an interlocutory order issued in consolidated proceedings on railroad and telephone depreciation instituted by the ICC on its own motion pursuant to Section 20(5). The order prescribed depreciation accounting to become effective January 1, 1928. Because of objections of the railroads, the effective date was deferred several times. The ICC subsequently reaffirmed its jurisdiction in *id.*, 177 I.C.C. 351 (1931). The ICC later rejected challenges to its authority to promulgate the uniform system of accounts except as to interstate operations in Accounting of N.Y. Tel. Co., 188 I.C.C. 83, 84-85 (1932), and Accounting Rules for Telephone Companies, 203 I.C.C. 13, 17 (1934).

26. Chairman Eastman, writing for the commission, said:

> It seems to be well established that where a local telephone company undertakes to originate or deliver toll messages, and most of them do so undertake, practically all of its property is open for use in interstate commerce and at any time may be so used. Under such circumstances, no doubt would seem to exist as to the power of Congress to regulate the accounting practices of such companies with respect to their property, including the accounting for depreciation.

Id., 118 I.C.C. at 332.

Rejecting NARUC's contention that the ICC should exercise its discretion "to refrain from prescribing depreciation requirements for the local telephone companies which in reality are engaged only to an insignificant extent in interstate commerce," Chairman Eastman continued:

> So far as the companies in classes A, B, and C are concerned, however, we are unable to conclude that the prescription of depreciation requirements by us ... is *impracticable*. Unless and until the provisions of paragraph (5) of Section 20 are changed

Later in the same proceeding the ICC again rejected challenges to its authority to mandate depreciation charges, pointing out that "obviously the 1920 amendment gives us the complete control over the substance of [depreciation] accounting...." *Id.*, 177 I.C.C. at 366 (1931).

NARUC's General Solicitor, John E. Benton, testified before the Senate Commerce Committee in 1930[27] and again in 1934,[28] that the States were bound by ICC prescriptions of depreciation and urged that the law be changed. Other witnesses agreed that

> by Congress, therefore, we ... must endeavor to enforce them in the case of such companies.

Id. at 332-33.

27. With his 1930 testimony Benton submitted for the record his article, "Why the State Commissions Oppose the Couzens Bill," containing the following paragraphs characterizing the Section 20 language incorporated in the 1929 bill (and later in the 1934 bills):

> The bill would also give the new commission the same power to control accounts and reports of companies which transmit intelligence as the Interstate Commerce Commission has over the accounts and reports of carriers subject to its jurisdiction. For this purpose appropriate sections have been incorporated from the interstate commerce act. Included is paragraph (5) of section 20, which makes it the duty of the commission to prescribe the depreciation charges of all carriers subject to the act.
>
> Under the provision the new commission would be obliged to prescribe the depreciation charges for every telephone company, however slight its participation in interstate business. * * *

Hearings on S. 6 before the Senate Committee on Interstate Commerce (71st Cong., 2d Sess.) 2224, 2229 (Feb. 5, 1930) ("Commission on Communications").

28. His 1934 statement said in this regard:

> Ever since Congress in 1920 empowered the Interstate Commerce Commission to prescribe rates of depreciation, the State commissions have believed that it would work to their embarrassment and do the public injury.
>
> * * *
>
> I wish to put into this record what I said on this subject at the hearing before this committee in February 1930, which was as follows:
>
> "Mr. BENTON. Now, as to depreciation. This bill provides that the new commission shall fix the rates of depreciation for each class of property for every company subject to its jurisdiction.
>
> "This has been the duty of the Interstate Commerce Commission ever since the enactment of the Transportation Act of 1920, both as to railroads and as to all companies subject to its jurisdiction.
>
> * * *

the ICC had preemptive authority under the 1920 Act.[29] Subsequently Benton testified before the House committee that the ICC then had the power to "override State regulation in the telephone field..." House Hearings at 135-36.

b. NARUC Opposed Initial Proposals to Transfer the ICC's Powers Over Depreciation.

The State commissions strenuously and repeatedly opposed any Congressional attempt to transfer to the new Communications commission the existing powers of the ICC over depreciation. The first serious Congressional effort to restructure Federal regulation of the telephone industry occurred in 1929. The 1929 bill, S. 6, introduced by Senator Couzens, the Republican chairman of the Commerce Committee, had simply copied the depreciation provisions of Section 20(5) into proposed Section 37(b), word-for-word. The NARUC witness vigorously opposed that aspect of the bill.[30] NARUC's annual conventions had passed

> "The State commissions believe that it is not in the public interest that this provision, providing for the Federal Commission to fix these rates of depreciation, should be in the law at all. * * *
>
> "It is dangerous, because if they are fixed wrong, then ... the State commission's hands are tied."

Hearings on S. 2910 before the Senate Committee on Interstate Commerce (73d Cong., 2d Sess.) 181 (March 15, 1934)("Federal Communications Commission"), *quoting* Hearings on S. 6 before the Senate Committee on Interstate Commerce (71st Cong., 2d Sess.) at 2213-14 (February 5, 1930)("Commission on Communications").

29. *See, e.g.*, Testimony of Kit F. Clardy, Chairman of NARUC's Legislative Committee, 1934 Senate Hearings, *supra*, 153 at 155 ("if [the ICC's present powers] were exercised to the fullest extent the State commissions would be entirely ousted from their jurisdiction.").

At the 1930 hearings AT&T President Gifford had testified that "all the accounts of all of our companies" were kept in accordance with the ICC's uniform system of accounts and that the ICC was "engaged in fixing our rates of depreciation." Hearings before the Senate Commerce Committee on S. 6 (71st Cong., 1st Sess.) 1990 ("Commission on Communications"); *cf. id.* at 2027, 2051. Frank B. McKinnon, President of USITA, told the Senate committee that the Independents similarly used a single, unseparated accounting system prescribed by the ICC. *Id.* at 2119 (February 3, 1930). Accord, Testimony of Charles C. Deering, Secretary of USITA, *id.* at 2139-40.

30. Testimony of NARUC's General Solicitor Benton, Hearings on S. 6 before the Senate Committee on Interstate Commerce (71st Cong., 2d Sess.) 2212-17, 2229 (Feb. 5, 1930)("Commission on Communications").

resolutions starting in 1922 and continuing through 1927 in opposition to the depreciation provisions of the 1920 Esch-Cummings Act.[31] The 1929 NARUC annual convention passed a resolution opposing S. 6, and this resolution and resolutions of thirty-seven states were printed in the 1930 hearing record.[32]

As a result of State objections, some changes were made in the rate provisions of the 1929 bill,[33] but the language based on Section 20(5) of the Esch-Cummings Act remained unchanged.[34]

c. S. 2910 and H.R. 8301, as Introduced in 1934, Contained Language Suggested by NARUC to Change the Law.

Companion bills[35] were introduced by the chairmen of the respective Commerce committees in February, 1934, in response to President Roosevelt's message calling for creation of the Federal Communications Commission.[36] Section 220 of both bills

31. Benton twice cited in the hearing record the 1923 NARUC resolution. 1930 Senate Hearings at 2215; 1934 Senate Hearings at 184. These NARUC resolutions are printed in NARUC's annual proceedings, as follows: 1922 at 273; 1923 at 302; 1924 at 242; 1925 at 382, 386-87; 1926 at 250-51 (semble); and 1927 at 550-51.

32. Hearings on S. 6 before the Senate Committee on Interstate Commerce (71st Cong., 2d Sess.) at 2168, 2170, 2222-23, 2232-85 (1930)("Commission on Communications"); 1929 NARUC Proceedings 423.

33. These changes were designed to reverse the *Shreveport* doctrine enunciated by the Court in 1914, discussed under point I(C), *infra* at 24, 27-30.

34. *See* Section 69(b) of the confidential committee print of S. 6, dated April 23, 1930. This is presumably the committee print referred to in Benton's House testimony May 9, 1934. House Hearings at 140.

35. S. 2910 (73d Cong., 2d Sess.)(Dill-D [Wash.]) and H.R. 8301 (73d Cong., 2d Sess.)(Rayburn-D [Tex.]).

36. Message from the President of the United States Recommending that Congress Create a New Agency to be Known as the Federal Communications Commission, S.Doc. 144 (73d Cong., 2d Sess.)(February 26, 1934); 78 Cong.Rec. 3259. The Presidential message was in response to Senator Dill's letter to the President, dated February 24, 1934, requesting such a message and enclosing a copy of a committee print of the bill "prepared under the direction of Congressman Rayburn and myself", and to the "Study of Communications by an Interdepartmental Committee," a copy of which the President had sent to Senator Dill the preceding month "in the hope that it may be of assistance to you and your associates on the committee in your further study of the subject and in the construction of the needed legislation."

This activity followed upon the President's pocket-veto of H.R. 7716 (72d Cong., 2d Sess.), which would have amended only the Radio Act of 1927.

contained the preexisting Section 20(5) language, but both bills contained three new paragraphs (h-j) suggested by NARUC.[37] Subsections (h) and (i) were essentially as enacted into law in 1934. Subsection (j), which was ultimately not adopted, read as follows:

> (j) Nothing in this section shall (1) limit the power of a State commission to prescribe, for the purposes of the exercise of its jurisdiction with respect to any carrier, the percentage rate of depreciation to be charged to any class of property of such carrier, or the composite depreciation rate, for the purpose of determining charges, accounts, records, or practices; or (2) relieve any carrier from keeping any accounts, records, or memoranda which may be required to be kept by any State commission in pursuance of authority granted under State law.

The proposed addition of paragraphs (h-j) to Section 220 was explained in the House committee report as emanating from NARUC's desire to change the existing law:

> Section 220 (a-g) is taken from section 20 (5-8) of the Interstate Commerce Act dealing with accounts, records, and memoranda. It also adds the new provisions found in subsections (h), (i), and (j). *Subsections (h), (i), and (j) are responsive to the requests of the State commissions that the present law be changed so as to permit those bodies to exercise, for State purposes, certain jurisdiction over accounting systems and methods of depreciation accounting.*

37. *See* Colloquy between Senators Dill and Long during the Senate hearings on March 15, 1934, at 179; Testimony of NARUC's legislative committee chairman, Kit F. Clardy, *id.* at 154 ("The State commissions have worked out that language rather carefully...."); Testimony of NARUC Solicitor Benton, *id.* at 180 ("those provisions are in the bill because of representations which were made by State Commission representatives") and at the House hearings at 140 (May 9, 1934); March, 1934, Senate committee prints of S. 2910 at 36 and S. 3285 at 39 (Committee Print No. 5); Remarks of Chairman Rayburn, 78 Cong. Rec. 10314 (June 2, 1934).

House Report No. 1850 to accompany S. 3285 at 7 (June 1, 1934) (emphasis added). The testimony of NARUC's witness acknowledged that the House bill as drafted "removes provisions of the law which are now existent" that deprive the State regulatory bodies of authority over depreciation. Testimony of John E. Benton, House Hearings at 139 (1934).

d. Congress Finally Rejected NARUC's Proposed Changes in the Law.

The language of paragraph (j), which would have changed the existing law to permit the State commissions to exercise certain jurisdiction over accounting systems and methods of depreciation, drew fire at the hearings on the companion bills in both houses. It was largely rejected by the Senate Committee and ultimately by the Conference committee. The Conference committee also rejected two conforming amendments to Section 220(a) and (b), suggested in NARUC's testimony before the House committee and incorporated in the bill as passed by the House.

Paragraph (j) drew a withering attack from AT&T President Gifford.[38] Critical comments were offered by the chairman of the ICC's legislative committee, Commissioner McManamy, who advised the committees that the NARUC-sponsored language

38. Gifford testified at the Senate hearings on March 13, 1934, and again at the House hearings on May 10, 1934, that the situation created by the proposed addition of paragraphs (h) and (j) would be "astonishing," "anomalous," and "chaotic." Hearings before the Senate Commerce Committee on S. 2910 (73d Cong., 1st Sess.) 95-97 ("Federal Communications Commission"); Hearings before the House Commerce Committee on H.R. 8301 (73d Cong., 1st Sess.) 189-91 ("Federal Communications Commission").

Of the proposed changes in Section 220 of S. 2910, Gifford said:

> Comment upon this wholly anomalous situation seems to be unnecessary. This section makes an orderly advance and then beats a disorderly retreat. Paragraph (j) and the last part of paragraph (h) strike down practically all the sound and salutary provisions of the preceding paragraphs, and introduce chaos in place of the present orderly, sound, tried, and tested accounting. This would create an impossible situation even for a company operating in only one State. As applied to companies whose property and business cover two or more States, and even as many as nine States in the case of one of our companies, it is clearly out of the question.

1934 Senate Hearings, *supra*, at 96.

was inconsistent with the present law as reflected in the statutory provisions carried over from Section 20(5):

> Paragraph (j) of these new paragraphs should be most carefully considered. It unquestionably directly conflicts with, and destroys the uniformity of systems of accounts and depreciation accounting required by the preceding provisions of the section. That is not true under the present law.

Senate Hearings at 208; House Hearings at 96.

In the clean bill, S. 3285, as reported by the Senate committee and passed by the Senate, paragraph (j) was completely revised.[39] The Senate's amended version eliminated the proposed exemption for State regulation of depreciation, and proposed a direction to the FCC simply to study and

> to report to the Congress whether in its opinion legislation is desirable ... permitting the State commissions, in pursuance of authority granted under State law, to prescribe their own percentage rates of depreciation or systems of accounts, records, or memoranda to be kept by carriers.

S. 3285 as reported April 17, 1934, at 40 (Calendar No. 830). The Senate committee print of S. 3285 explained that this language was "in lieu of granting such authority to the States."[40]

At the following House hearings NARUC vigorously attacked the Senate change as "crippling State regulation".[41] The House

39. NARUC Solicitor Benton later ascribed the Senate's revision of paragraph (j) to a "response to a very vigorous attack made upon the accounting sections by President Gifford before the Senate committee." Hearings on H.R. 8301 before the House Commerce Committee (73d Cong., 2d Sess.) at 140 (April 10, 1934)("Federal Communications Commission").

40. Senate Committee Print No. 5 at 39 (April, 1934). The Senate committee report to accompany S. 3285, S. Rpt. No. 781 (April 19, 1934), similarly notes at 2, 5 that under Section 220 the new commission is directed to investigate the "desirability of permitting state regulation of ... rates of depreciation charges.... instead of immediately turning over these matters to the State."

41. Testimony of Kit F. Clardy, Chairman of NARUC Legislative Committee, at Hearings on H.R. 8301 before the House Commerce Committee (73d Cong., 2d Sess.) at 70, 73 (April 11, 1934) ("Federal Communications Commission").

committee apparently accepted NARUC's urgings "that the present law be changed" to permit the State commissions "to exercise, for State purposes, certain jurisdiction over accounting systems and methods of depreciation accounting." H. Rpt. No. 1850 to accompany S. 3285 at 7 (June 1, 1934). The committee reported the bill with paragraphs (h-j) and certain conforming amendments to Section 220(a) and (b), as proposed by NARUC, and the House adopted the bill as reported, including the "*changes* [in Section 20 of the Interstate Commerce Act] necessary to permit State commissions to prescribe the systems of accounts for the intrastate operation of carriers." Remarks of Chairman Rayburn, 78 Cong. Rec. 10314 (June 2, 1934)(emphasis supplied).

The bills then went to conference. The Conference committee rejected the NARUC-sponsored language of the House bill and instead reported a Subsection (j) very closely tracking the "study and report" language of the Senate bill:

> (j) The Commission shall investigate and report to Congress as to the need for legislation to define further or harmonize the powers of the Commission and of State commissions with respect to matters to which this section relates.

The States' brazen attempt here to read the "investigate and report" language of Subsection (j) as *restricting* the FCC's power to prescribe accounts and depreciation to interstate services pending further legislation[42] --rather than reaffirming that power unless Congress later decided to restrict the power -- is refuted by other Conference committee action. The committee also rejected two other amendments to Section 220 that would have explicitly accomplished such a restriction on FCC authority. The House committee, at the urging of NARUC,[43] had amended the Esch-Cummings language in Subsections 220(a) and (b) to "avoid conflict" between those paragraphs and the paragraph (j)

42. California argues that Subsection (j), "as finally enacted ... expressly assumed dual regulation of depreciation and accounting matters." California brief at 21; *cf. id.* at 21-24, Louisiana brief at 37.

43. Testimony of NARUC's Benton before the House committee, May 9, 1934, House Hearings at 144.

language previously proposed by NARUC.[44] The Conference committee, concurrently with its rejection of the House version of Subsection (j), also rejected the House's proposed curtailment of FCC authority under Subsections 220(a) and (b).

The conference report was adopted by both houses; and the bill was signed by President Roosevelt on June 19, 1934. The conference bill, as signed into law, deliberately rejected the kind of language that Congress used when it wanted to permit States to make autonomous decisions about depreciation in *other* regulated industries.[45] Thus, the legislative history of Section 220 is as clear as any legislative history can be that Congress -- in carrying into the new act the language from Section 20(5) of the Esch-Cummings Act -- specifically considered, and consciously and unmistakably rejected, the States' attempt to prevent the FCC from succeeding to the ICC's plenary authority over accounting and depreciation.[46] As ICC Commissioner McManamy pointed

44. The House Committee, pursuant to NARUC's suggestion, amended Section 220(a) by deleting the words "any and all" before the word "accounts" ("The Commission may ... prescribe the forms of [any and all] accounts ... to be kept by carriers subject to this Act ...") and amended Section 220(b) by adding the phrase, "in the accounts prescribed by the commission," so that it read, in part, "After the Commission has prescribed the classes of property for which depreciation charges may be included, no carrier shall, *in the accounts prescribed by the Commission*, charge to operating expenses any depreciation charges on classes of property other that those prescribed by the Commission...."

45. In the Federal Power Act, passed in 1935, and in the Natural Gas Act, passed in 1938, language similar to NARUC's paragraph (j) was included, in conjunction with other language somewhat similar to the provisions of Section 220(b) of the 1934 Act. In those enactments Congress added a provision expressly preserving any State jurisdiction over depreciation:

> Nothing in this section shall limit the power of a State commission to determine in the exercise of its jurisdiction, with respect to any natural-gas company, the percentage rates of depreciation or amortization to be allowed ... for the purpose of determining rates or charges.

15 U.S.C. § 717h(a); virtually identical language appears in 16 U.S.C. § 825a(a). Congress used similarly explicit language in Section 213(h) of the Communications Act pertaining to valuations of carrier property, as it also did in Section 221(b).

46. The transition provisions in Section 604 of the 1934 Act, now 47 U.S.C. § 704 (1985), providing that the ICC's determinations of carriers' depreciation charges should continue in effect under the new act, further suggest that the 1934 Congress perceived no inconsistency between the existing authority of the ICC over depreciation and that conferred on the new FCC.

out, the pre-existing scheme provided for a Federal regulatory agency to impose coherent systems of accounts and depreciation; Congress rationally opted to continue the unified approach rather than to create a crazy-quilt of bifurcated depreciation systems. The FCC's order here does no more than implement that Congressional decision.

C. Section 2(b) Does Not Limit the Preemptive Force of FCC Prescriptions Under Section 220(b).

The States' argument that the intrastate exemptions in Section 2(b) limit the FCC's power under Section 220(b) to prescribe depreciation for carrier property is incorrect, both as a matter of textual analysis and as a matter of historical fact.[47]

1. *Section 2(b) Does Not Bar Federal Regulation of "Dual Jurisdiction" Property.*

Section 2(b) cannot sensibly be read as foreclosing what Sections 1 and 2(a) expressly establish as the primary goals of the Act: comprehensive and effective Federal regulation of interstate carriers and property used in interstate (as well as intrastate) communications.

Section 2(b)(1) has as its limited purpose the reversal of the *Shreveport* doctrine.[48] The exception at most reserves State authority over purely intrastate rates and purely intrastate facilities. This case, however, involves *carriers* over whom the FCC has explicit jurisdiction, because they are involved in interstate communications, and it involves facilities jointly used in *interstate* (as well as intrastate) communication, rather than solely in intrastate communication. Thus, this narrow intrastate exception to the Congressional plan giving the FCC comprehensive jurisdiction over the interstate telephone network does not diminish the FCC's ultimate power over facilities used in interstate communication.

47. In pertinent part, Section 2(b) of the 1934 Act exempting intrastate service and connecting carriers from Federal jurisdiction provides:

> [N]othing in this Act shall be construed to apply or to give the Commission jurisdiction with respect to (1) charges, classifications, practices, services, facilities, or regulations for or in connection with intrastate communication service by wire or radio of any carrier, or (2)any carrier engaged in interstate or foreign communication solely through physical connection with the facilities....

47 U.S.C. § 152(b) (App. I at I-3-5.)

48. Section 2(b)(1) was intended to reverse the Court's holding in *Shreveport, supra*, that the intrastate proviso in Section 1 of the Interstate Commerce Act did not prevent the ICC from directly ordering intrastate rates raised to eliminate discrimination against interstate commerce. *See* point I(C)(2), *infra*.

The States' argument that property used even in part in intrastate communications is immunized from Federal regulation simply proves too much, and it has been rejected by the FCC and by every Federal court that has considered it. *See North Carolina Util. Com'n* v. *FCC*, 552 F.2d 1036, 1045-49 (4th Cir. 1977), *cert. denied*, 434 U.S. 874 (1977)(North Carolina II); *CCIA* v. *FCC*, 224 U.S.App.D.C. 83, 99-103, 693 F.2d 198, 214-18 (1982), *cert. denied*, 461 U.S. 938 (1983); *New York Tel. Co.* v. *FCC*, 631 F.2d 1059, 1064-66 (2d Cir. 1980); *Puerto Rico Tel. Co.* v. *FCC*, 553 F.2d 694, 699-700 (1st Cir. 1977).[49]

The States argue that the FCC's prescription of depreciation for dual jurisdiction property would impinge on the exclusive power to set intrastate rates, reserved to them under Section 2(b)(1) of the Act. Their argument overlooks the fact that their "reserved" jurisdiction under Section 2(b)(1) as to dual-jurisdiction property goes no further than Congress chose to allow it in pursuing the overriding national goal of effectively promoting and regulating an integrated interstate telephone system. Congress' decision to give the FCC the power to prescribe depreciation rates and methods for dual jurisdiction property no more impinged on the claimed prerogatives of the States than did Congress' analogous grant to the FCC in Section 221(c) of final authority to classify such mixed use property by jurisdiction, even though those Federal determinations have a profound inpact on local rates. Similarly the FCC's ultimate power to impose depreciation policies complements the FCC authority pursuant to Section 214(a) and (d) to authorize or require construction of facilities

49. *See also* Virginia State Corp. Com'n. v. FCC, 737 F.2d at 392-96 (A-8-17), rejecting the contention below; NARUC v. FCC, 237 U.S.App.D.C. 390, 408-10, 737 F.2d 1095, 1113-15 (1984), *cert. denied*, 105 S.Ct. 1224 (1985).

without concurrent State approval.[50] In each case Congress provided for State participation in the decision- making process, but assured Federal supremacy, if a conflict might undermine the statutory goals. *See* Sections 214(b), 220(i), 221(c), and 410(b).

2. *The Section 2(b) Exemptions Do Not Override the FCC's Authority Under Section 220(b) to Prescribe Depreciation Rates and Methods.*

The Section 2(b)(1) exemption for "intrastate communication service" does not override the requirement for Federally prescribed uniform accounts and depreciation systems under Section 220(b). It is plain both textually and structurally that Section 2(b) was not intended to limit the FCC's authority to prescribe such systems.

Section 2(b)(1) is but a paraphrase of the language of Section 1 of the Interstate Commerce Act. As a result of the 1920 amendments, Section 1(2) of the Interstate Commerce Act read in pertinent part:

> (2) The provisions of this Act shall ... not apply -- ... to the transmission of intelligence by wire or wireless wholly within one State....

41 Stat. 474.[51] This is substantively indistinguishable from Section 2(b)(1) of the 1934 Act.[52]

As has been previously noted, however, and as is demonstrated in Appendix III, *infra*, Section 220(a) and (b) were copied almost word-for-word from Section 20(5) of the Esch-Cummings amendments of 1920. Predecessor language in Section 1 of the Esch-Cummings Act of 1920 was never considered to limit

50. Section 214(c) specifically provides that after issuance of a certificate of public convenience and necessity by the FCC the carrier may proceed with the construction, etc., authorized therein "without securing approval other than such certificate".

51. This language was essentially a reenactment of the language of Section 1 of the Mann-Elkins Act of 1910, 36 Stat. 539, 545, which brought communications carriers under the Interstate Commerce Act. The 1920 reenactment of the language is significant because contemporaneous with the enactment of Section 20(5) and hence *in pari materia*.

52. "[N]othing in this Act shall be construed to apply or to give the Commission jurisdiction with respect to ... charges, classifications, practices, services, facilities, or regulations for or in connection with intrastate communication service ... of any carrier...." 48 Stat. 1064, 47 U.S.C. §152(b)(1)(App. I at I-5).

the preemptive effect of the ICC's prescriptions.[53] Just as that language did not limit the plenary authority of the ICC with respect to depreciation under the predecessor language of Section 220(b), so Section 2(b)(1) does not limit the FCC's plenary authority under Section 220(b).[54]

The limited purpose behind Congress' confining of the 1934 exemption to carriers' "intrastate communication service" is borne out by its legislative history. Section 2(b)(1) was inserted into the Couzens bill in the Spring of 1930[55] at the request of NARUC.[56] NARUC's purpose, readily acceded to by all the government parties to the legislative process, was to prevent application of the *Shreveport Doctrine* to communications. The precise holding of this Court in *Shreveport*[57] was that the intrastate proviso in Section 1 of the Commerce Act[58] did not prevent the ICC from directly ordering intrastate *rates*, tariffed with the State commissions, raised to eliminate discrimination against interstate commerce.[59]

To meet these vehement objections by NARUC to the application of the *Shreveport Doctrine* to intrastate telephone rates -- which, unlike the railroads' tariffs, covered some ninety percent of

53. *See* Point I(B)(2)(a), *supra* at 15-17.

54. Of the predecessor language of Section 2(b)(1), NARUC's General Solicitor Benton wrote: "[T]he saving language ... can not be expected to be more effective in this act ... than the same language has heretofore proved to be in the act creating the Interstate Commerce Commission." 1930 Hearings at 2226-27.

55. Committee print of S. 6 (71st Cong., 1st Sess.), §65(d), at 76 (April 23, 1930).

56. Testimony of NARUC's General Solicitor Benton before the House Committee, May 9, 1934. Hearings at 136; *cf. id.* at 139-40.

57. Houston, E. & W. Tex. Ry. v. U.S., *supra*.

58. "*Provided, however*, that the provisions of this Act shall not apply to the transportation ... wholly within one State...." 36 Stat. 544 (1910).

59. This holding was embodied in the Interstate Commerce Act by Section 416 of the Esch-Cummings Act, which added to Section 13 of the 1887 Act two new paragraphs, specifying procedures to be followed when the ICC encountered discriminatory intrastate rates and providing that the corrective tariff prescribed by the ICC should override "the law of any State or the decision or order of any State authority to the contrary notwithstanding." 41 Stat. 484. These provisions were carried over into Section 35(c) and (d) of the Couzens bill of 1929, S. 6 (71st Cong., 1st Sess.).

the traffic[60] --the Senate committee added the following provision to Section 65 of S. 6:

> (d) Nothing in this Act shall be construed to authorize the commission to regulate rates, charges, or services for or in connection with any intrastate communication by wire or radio whether for the purpose of removing discrimination against interstate commerce or for any other purpose.

Confidential committee print of S. 6 (71st Cong., 1st Sess.) at 76 (April 23, 1930). The "whether" clause showed a primary intent to reach the holding of the *Shreveport* rate case, while also closing off any other rationale for direct Federal regulation of rates for intrastate services.

Though the language was subsequently revised and moved to Section 2(b) of the 1934 bills and, ultimately, of the Act, nothing in the NARUC testimony before the Senate and House committees and the reports and debates with respect thereto evinces any intent to reach specific situations beyond direct Federal ratesetting such as in *Shreveport*.[61]

That the State commissions' concern should have been centered on the ultimate rates to be charged for "intrastate communication service" is understandable,[62] since the State commissions' regulation of telephone companies largely focussed on rates.[63]

60. Testimony of F. B. MacKinnon, President of USITA, before Senate Committee on Interstate Commerce, February 3, 1930. 1930 Senate hearings at 2124-25, 2127-29, 2134.

61. The evolution of Section 2(b) is detailed in Appendix II, *infra*.

62. Under questioning from Congressmen Monaghan (D-Mont.), Pettengill (D-Ind.), and Merritt (R-Conn.) in 1934, NARUC's witness admitted that the State commissions had encountered difficulty in effectively regulating the telephone companies. House Hearings at 141. The same witness had previously testified to difficulties of the same kind with respect to depreciation specifically. 1930 Senate Hearings at 2217. *See also* testimony of Paul Walker, then chairman of the Oklahoma Corporation Commission and later author of the FCC's "Walker Report," characterizing the State commissions as "practically helpless" in the face of the vast "telephone problem." House Hearings at 69. *Cf.* Wheat, "The Regulation of Interstate Telephone Rates," 51 Harv.L.Rev. 846, 847 (1938) ("The complex nature of the telephone business ... has frequently rendered state regulatory efforts ineffective, and in certain respects wholly nugatory.").

63. Although State statutes providing for certificates of public convenience and necessity began to supersede legislative charters as the

The States further argue that this Congressional assignment of authority over dual jurisdiction property should be flouted, because it is supposedly inconsistent with the State's responsibility for setting rates for intrastate services recognized in Section 2(b)(1). The FCC's power to prescribe depreciation, however, is not the same as the power, invoked by the ICC in *Shreveport*, to prescribe the actual intrastate rates themselves. Contrary to the States' assertions, the FCC did not preempt the ratemaking process at the State level.

What the States ignore is that not everything impacting rates is ratemaking. *See Western Un. Tel. Co.* v. *FCC*, 214 U.S.App.D.C. 308, 333, 665 F.2d 1126, 1151 (1981). As the FCC explained below, "The setting of depreciation rates and classes of depreciable property only resolves a single issue impacting the ratemaking process." *1983 Preemption Order*, 92 F.C.C.2d at 874 (A-41). The other elements of the ratemaking process remain undisturbed in the State regulatory process. Depreciation charges, when Federally prescribed, are no different from other externally determined expenses that are not under the control of the State regulators, such as labor costs or Federal taxes, that must be recognized in the State ratemaking process. As the ICC noted early on,[64] "depreciation is a fact" to be taken into regulatory account.

The FCC was careful to limit its preemption within the scope of both established case law and the terms of its governing Federal statute. Executing the explicit direction of Congress expressed in Section 220(b) of the Act and finding it necessary to achieve the statutory goal of an efficient nationwide telecommunications service, the Commission preempted only one element of telephone plant regulation: depreciation of plant used jointly for interstate

instruments of State regulation of rail routes in the years preceding the First World War, the intervention of the War, Federal operation of the railroads, and the general financial weakness of the railroads rendered more-or-less moot the question of State commission power to issue route certificates. *See* Jones: "Origins of the Certificate of Public Convenience and Necessity: Developments in the States, 1870-1920," 79 Colum.L.Rev. 426, 455 (1979). In many States during this era the territory of telephone companies was delimited by municipal franchises rather than by State certificates.

64. Telephone and Railroad Depreciation Charges, 118 I.C.C. 295, 325-326 (1926).

and intrastate communications. Hence the *Shreveport* reservation of the 1934 Act is not relevant here.

The States' argument[65] that the "charges" exempted by Section 2(b)(1) encompasses "charges for depreciation" involves merely a clever word game. It is clear that "charges" in Section 2, as elsewhere in Sections 1, 201-05, etc., refers only to *rates* paid by the telephone subscribers. In Section 2(b), therefore, the term means only that, contrary to *Shreveport*, the FCC should not have authority to prescribe the rates tariffed for intrastate telephone service.

Even if, standing alone, Section 2(b) might appear to have a broader implication, Congress dealt specifically with the issue of Federal-State authority over carriers' depreciation. Depreciation has always been considered a special and separate matter in regulated industries. Section 220(b) specifically and independently gives the FCC the power to prescribe depreciation rates and methods and to make those prescriptions conclusive for all regulatory purposes. To read Section 2(b) as exempting State commissions from Federal depreciation requirements would render redundant the more carefully considered and circumscribed exemptions of Section 220 and would offend the canon of statutory construction that the more specific language controls the more general.[66]

Moreover, to construe the exemptions of both Section 2(b) and 220 as reading on accounts and depreciation would produce redundant (but inconsistent) treatment of the same subjects.[67]

65. California brief at 14-16.

66. In the *Special Permission* case, AT&T v. FCC, 487 F.2d 865, 877 n. 26, (1973), the Second Circuit applied to construction of the 1934 Act "the maxim that general language of a statute usually does not apply to a matter specifically dealt with in another part of the same statute," *citing* Ginsburg & Sons v. Popkin, 285 U.S. 204, 208 (1932). *Cf.* Fourco Glass Co. v. Transmirra Prod. Corp. 353 U.S. 222, 228-29 (1957); Bulova Watch Co. v. U.S., 365 U.S. 753, 758 (1961) ("familiar law"); Fidelity Fed. S.& L. Ass'n. v. de la Cuesta, 458 U.S. 141, 163 (1982).

67. The redundancy is avoided when the Court recalls that NARUC's legislative proposal in 1934 treated the proposed exemption from Federal control over depreciation separately from Section 2(b)'s reservation of residual power over rates for local services. NARUC's proposed clause to save States' rights in Section 220(j) of S. 2910 and H.R. 8301 was expressly limited to "Nothing in this section...", again suggesting that Section 220 was intended to be a self-contained treatment of accounting and depreciation.

Such a redundant reading would be particularly illogical, since both Section 2(b) and Section 220(h)-(j) had a common origin in the NARUC-sponsored provisions in the companion bills introduced in February, 1934.[68] If the language of Section 2(b)(1) had been viewed as sufficient to foreclose Federal preemption of depreciation, NARUC would not have found it necessary to press so vigorously -- but unsuccessfully -- to include in Section 220 its proposed paragraph (j)(1), exempting State prescriptions.[69]

The States cannot responsibly invoke Section 2(b) now to derive the authority that Congress specifically decided not to give them when it addressed and, ultimately, rejected, their proposed amendment to Section 220 itself.

II.

THE FCC PROPERLY DECLARED ITS PRESCRIPTION PREEMPTIVE.

The FCC's decision below to preempt inconsistent State depreciation orders was an agency option plainly contemplated by Congress in 1934, and the Commission fully justified its decision to preempt inconsistent State depreciation systems.

68. Any suggestion that Section 221(b) adds to Section 2(b)(1)'s intrastate exemption, *see* Louisiana brief at 33, should similarly be rejected on the ground of redundancy. Every court that has considered the argument has rejected it, recognizing that the Section 221(b) exemption applies only in the specific case of local exchange service crossing state lines, such as in the Kansas City and Washington, D.C., metropolitan areas. *See* CCIA v. FCC, 224 U.S.App.D.C. 83, 101-02, 693 F.2d 198, 216-17 (1982), *cert. denied*, 461 U.S. 938 (1983); North Carolina Util. Com'n. v. FCC, 537 F.2d 787, 795 (4th Cir. 1976), *cert. denied*, 429 U.S. 1027 (1976); Puerto Rico Tel. Co. v. FCC, 553 F.2d 694, 698-99 (1st Cir. 1977); New York Tel. Co. v. FCC, 631 F.2d 1059, 1064-65 (2d Cir. 1980); *cf.* S. Rept. No. 781 (73d Cong., 2d Sess.) 5 (1934); H. Rept. No. 1850 (73d Cong., 2d Sess.) 7 (1934); Remarks of Congressman Rayburn, 78 Cong. Rec. 10314 (June 2, 1934); Remarks of Sen. Dill, 78 Cong. Rec. 8823 (May 15, 1934); *see also id.* at 8846-47; Testimony of NARUC's General Solicitor Benton, House hearings at 137, *citing* Pennsylvania Gas Co. v. New York PSC, 252 U.S. 23, 30-31 (1920) (interstate pipeline providing local service held subject to State regulation in the absence of Federal regulation).

69. Similarly, Sections 213(h) and 221(d) would have been unnecessary if Section 2(b)(1) had been intended to limit FCC valuations of carrier property.

A. The Commission Followed Congressional Intent in Preempting State Orders.

Congress clearly contemplated that in appropriate circumstances the FCC, no less than the ICC, should preempt inconsistent State depreciation orders in the interest of uniformity. *Cf. Capital Cities Cable* v. *Crisp*, 104 S.Ct. 2694, 2700 (1984). As demonstrated in Point I(B)(2)(a) above, the Section 20(5) language, which was carried over into Section 220(b) of the '34 Act, authorized the agency to issue preemptive orders. Indeed, the ICC construed the language as requiring it to do so, save for telephone companies so small it was impractical.[70] Knowing of this preemptive construction, Congress reenacted the Section 20(5) language as part of the Communications Act. On this basis alone the Court should sustain the two commissions' interpretation of their own statutes as giving Federal prescriptions of depreciation rates and methods preemptive effect.

In addition, Congress made specific provision in the 1934 Act in contemplation of preemption. Congress would have had no reason to include in Section 220(i) a provision requiring mandatory consultation with the States on accounting and depreciation matters if it had not contemplated that FCC orders would affect State regulatory decisions. Nor would there have been any conflict to "harmonize" through future legislation, as contemplated by Section 220(j), if Congress had not recognized that the FCC's depreciation prescriptions would impinge upon the State ratemaking process. Thus, Section 220 unmistakably contemplates that the FCC could impose its determinations if consultations did not achieve consensus.

On the record here the FCC had an adequate basis to conclude that it should not, under Section 220(h), waive the presumptively preemptive effect of its depreciation prescriptions. It also had an adequate basis to conclude that, apart from any preemptive effect flowing directly from Section 220(b), achievement of its statutory purposes reasonably required it to preempt inconsistent State systems of depreciation.[71] *See Capital Cities Cable* v. *Crisp*,

70. Telephone and Railroad Depreciation Charges, 118 I.C.C. 295, 333 (1926), quoted in note 26, *supra*.
71. 737 F.2d at 394, 396 (A-12-17).

supra, at 2703; *Fidelity Fed. S. & L. Ass'n.* v. *de la Cuesta*, *supra*, at 153-54, 169-70.

B. The FCC's Decision Not to Use Its Preemptive Power Over Depreciation in Prior Matters Did Not Forfeit Its Power to Do So Here.

Past practices of the FCC and the State commissions do not require a construction of the statute making Federal depreciation orders non-preemptive. Agency practice after 1920 involving a cooperative division of responsibilities between the ICC and the States was in accord with the best traditions of Federal-State cooperation.[72] The holdings of *Smith* v. *Illinois Bell Tel. Co.*, 282 U.S. 133, 159-60 (1930), and *Northwestern Bell Tel. Co.* v. *Nebraska State Ry. Com'n.*, 297 U.S. 471, 478 (1936), that State determinations with respect to telephone company accounts should govern until displaced by subsequent, inconsistent Federal determinations, fully validated that agency practice. *Cf. Arkansas Elec. Coop.* v. *Arkansas PSC*, 461 U.S. 375, 388-89 (1983).

The past practice is consistent with the language of (i) Sections 20(5) and 220(b), which contemplates that the Federal commission might not instantaneously prescribe depreciation; (ii) Section 220(h), which contemplates that the FCC might elect to leave particular classes of carriers subject to prior-existing State regulation; and (iii) Section 410(b), which authorizes the Federal commission "in the administration of this Act to avail itself of such cooperation, services, records, and facilities as may be afforded by any State commission."[73] The FCC's practice of holding "three-way meetings" on depreciation with the State and the affected carrier is wholly consistent with Section 220(i), which authorizes the Commission to "consult" with the States but does not require it to accede to non-uniform accounting systems.

72. In its 1926 depreciation order the ICC expressed confidence in its ability to deal with deficiencies in the carriers' accounts brought to its attention through "the helpful cooperation which we anticipated from those [State] commissions in the administration of telephone depreciation accounting." Telephone and Railroad Depreciation Charges, 118 I.C.C. 295, 347.

73. The language of Section 410(b) was derived from Section 13(3) of the Interstate Commerce Act, which had been relied on by the ICC in its depreciation proceeding under the 1920 Act. *See* Telephone and Railroad Depreciation Charges, 118 I.C.C. 295, 333 (1926).

Many of the cases cited here by the States for the proposition that the States have historically prescribed telephone company accounts on their own authority are readily explicable by reference to the provision of the FCC's Uniform System of Accounts that expressly *allows* the States to require sub-accounts for state regulatory purposes.[74] Moreover, actions and pronouncements of the State commissions are not persuasive constructions of the Federal statute under the contemporaneous agency construction doctrine. In any event, this Court has twice approved mandatory accounting prescriptions by the FCC. *See AT&T* v. *U.S.*, 299 U.S. 232 (1936); *U.S.* v. *New York Tel. Co.*, 326 U.S. 638 (1946).

The FCC's willingness to defer the preemptive force of its prescriptions until it became apparent that non-conformity by the States was becoming a significant problem was an appropriate exercise of Federal-State comity. When the FCC did preemptively prescribe depreciation rates and methods, it adequately explained why it had determined no longer to allow carriers and State commissions to depart from a uniform depreciation system.[75]

74. Section 220(g) permits the FCC *to authorize* departures from its Uniform System of Accounts. *See* Accounting Rules for Telephone Companies, 203 I.C.C. 13, 16 (1934); Uniform System of Accounts, 47 C.F.R. §§ 31.01-1(f), 31.01-2(d) and (f), and 33.12(d). In its *1983 Preemption Order*, however, the FCC pointed out the practical limitation to the States' account subdivision argument:

> A subdivision rule, however, does not permit what is accounted for as an expense to be capitalized in the guise of subdividing an expense account. While we may allow subdivisions of accounts, we will not allow inconsistent accounting or depreciation methods unless such practices are otherwise consistent with the public interest.

Op. cit., 92 F.C.C.2d at 873-74 (A-40). *Cf.* Accounting Rules for Telephone Companies, *supra*, at 16-17.

75. In the *1983 Preemption Order* the Commission explained the changed circumstances bearing on depreciation rates and methods in these terms:

> In the past the communications marketplace was typified by monopoly conditions and life and salvage factors underlying the state rates were generally very similar, if not identical, to those used by the Commission. In that environment it was not essential that the Commission assert all the authority granted it. *See Computer and Communications Industry Association* v. *FCC* [224 U.S.App.D.C. 83, 693 F.2d 198 (1982), *cert. denied*, 461 U.S. 938 (1983)]. As discussed, *infra*, in the more competitive conditions prevailing today, the utilization of proper methods and rates is more critical if the proper incentives are to be created to insure that the marketplace will function efficiently to bring the benefits of the competition to the ratepayers of this country.

Op. cit., 92 F.C.C.2d at 874 (A-40-41).

C. Preemption Was Necessary to Avoid Frustration of Federal Depreciation Policies.

The FCC reasonably concluded that preemption of inconsistent State depreciation orders was necessary to avoid frustration of Federal depreciation policies. The agency's expert judgment on that point is entitled to judicial deference.

The determination by the Commission in its *1983 Depreciation Order* no longer to allow carriers to depart from uniform Federal depreciation rates and methods was a reasonable one in light of current conditions in the telephone industry. The introduction of competition into a heretofore monopolistic environment by the FCC and the Bell divestiture by the courts, among other developments, had rendered inadequate previous rates and methods of depreciation. Discrepancies between Federal and State depreciation rates and methods had become large, as (i) the useful lives of telephone plant became shorter due to technological and economic obsolescence and (ii) the accumulating reserve deficiencies of the carriers (due to under-depreciation) became economically intolerable.[76]

As a practical matter, preemption was necessary to avoid the mathematical impossibility of reconciling inconsistent State and Federal rates and methods of depreciation for the same property. This mathematical impossibility was meticulously demonstrated to the FCC in the petition of GTC of Ohio (J.A. 89, 92-97, 119-21).

The nature of depreciation in rate-regulated industries makes it inherently undesirable to apply inconsistent rates and methods to

76. *See 1983 Preemption Order*, 92 F.C.C.2d at 874, 876-78 (A-40-41, 44-47). A recent study by an agency of the Department of Commerce has pointed to an aggregate reserve deficiency of as much as $25 billion. *See* National Telecommunications and Information Administration: Issues in Domestic Telecommunications: Directions for National Policy 142 (NTIA Spc.Pub. 85-16) (DOC 1985).

the same items of telephone plant and other equipment in calculating Federal and State rates.[77] In its *1983 Depreciation Order* the FCC reasonably determined that proper depreciation could not be achieved with inconsistent rates and methods applicable to the same property -- the ratepayer would either be charged too much or too little over the life of the property, and consequently the carrier would recover either more than its investment or less than its investment. *Op. cit.*, 92 F.C.C.2d at 878 (A-47).

The States would have the Court believe[78] that the total investment in a single piece of plant can be divided jurisdictionally on the books of the telephone company and that differing rates and methods of depreciation can be successfully applied to the two fractions. This is arguably true only in the most theoretical sense, but the FCC was surely authorized to take a more practical and realistic approach. In the absence of uniform treatment, discrepancies between actual investment and aggregate recovery of that investment through differing annual depreciation charges would inevitably result. *Id.* at 878 (A-47). Thus, the utility would either recover less than or more than 100 percent of its investment. Congress clearly intended that this not happen.

In point of fact, application of differing rates of depreciation -- which implies differing lives -- to the two jurisdictional portions of the same piece of equipment will inevitably result in frustrating the whole purpose of depreciation, which is to match depreciation charges of the equipment with the revenues generated by its use. In real terms this means either that the equipment is retired before the investment has been recovered through depreciation on the longer-lived portion, or that the equipment remains in service while no depreciation is being accrued on the shorter-lived portion. Either case offends the principles and underlying concepts of depreciation, for which Congress provided.

77. It should be "obvious," NARUC told the ICC shortly after the Esch-Cummings Act was passed in 1920, that, "where the same property is used for interstate and intrastate service, two different sets of rates for depreciation do not prevail." *See* Remarks of Commissioner Hopple, Chairman of the Ohio PUC, in NARUC Proceedings 460, 465 (1936).

78. *See* Louisiana brief at 40-41; *cf.* California brief at 4-5 n. 6.

As another practical complication, the FCC was entitled to take into account that, under the Separations Manual, the jurisdictional apportionment of investment is recomputed periodically.[79] Thus, not only would differing rates of depreciation be charged as to each jurisdictional fraction of the equipment during its physical life, but the sum of the two depreciation charges would fluctuate year-by-year over the joint in-service life of the two portions. Again, the end result would inevitably be under-depreciation or over-depreciation. *Id.* at 878 (A-47).

These discordant consequences have several effects that the FCC was entitled to avoid. First, discrepancies in depreciation for the same property misallocate the costs of service between interstate and intrastate ratepayers. Second, inaccurate or unrealistic schedules for depreciation frustrate the goal of having the ratepayer actually benefitting from the equipment pay his proper share of its cost. Third, artificially delaying full recapture of capital investment discourages or prevents investment in new technology. Since the same plant is used for both interstate and intrastate communications, a State commission's willingness -- under local pressure from some ratepayers or otherwise -- to retard new investment necessarily creates a drag on the interstate network itself. In practical terms, therefore, State depreciation policies are not severable from their impact on the integrated interstate communications system.

With considerable prescience, Congress in 1934 plainly contemplated a comprehensive depreciation system for the telephone industry. In Section 220 Congress explicitly assigned to the FCC the responsibility for telephone company depreciation, with all the powers necessary to discharge that responsibility. Presented here, therefore, is not a question of merely ancillary power but the exercise of a charter explicitly issued by Congress to the FCC. The FCC's judgment, pursuant to that charter, that preemption now is required was solidly founded on the practical necessities of achieving a workable depreciation system in an era of rapid technological and economic obsolescence. *Cf. Florida L. & A. Growers* v. *Paul*, 373 U.S. 132, 142 (1963).

79. *E.g.*, FCC Rules, 47 C.F.R. § 67.611 (1984). *See 1983 Preemption Order*, 92 F.C.C.2d at 878 (A-47).

Only after a long and careful study of the depreciation problem in Docket No. 20188[80] did the FCC conclude that the changed telecommunications environment required the adoption of new depreciation policies to allow full and timely recovery of capital. That is the sort of agency judgment that is entitled to the fullest judicial deference. Since Congress manifested in Section 1 of the 1934 Act its intent to centralize in the FCC the authority needed to achieve what are critical *national* goals, the Court should defer to the agency's judgment that allowing inconsistent State depreciation orders would undermine important Federal policies for achieving those goals.

80. Property Depreciation, 83 F.C.C.2d 267 (1980) (J.A. 4), *recon. denied*, 87 F.C.C.2d 916 (1981) (J.A. 45). Docket No. 20188 involved an exhaustive study of depreciation over a seven-year period. It included thousands of pages of submissions by industry and State commissions, among others; a special study by Ernst & Ernst, Inc., commissioned by the FCC; and a review of the entire subject of depreciation by Commission staff reflected in a "Primer" made part of the record. Further, the Commission, sitting *en banc*, heard presentations by Commission staff as well as industry spokesmen stressing the critical importance of depreciation in the new environment of telecommunications. Similarly, in Docket No. 79-105 below, extensive Commission resources were dedicated, over a period of several years, to reviewing the issues in light of more thousands of pages of submissions, again including submissions by State commissions. With active participation by Commissioners, this led first to the Commission's expensing and amortization program for station connections, Amendment of Part 31, 85 F.C.C.2d 818 (1981), and then to the *1983 Preemption Order*. It would be difficult to conceive of an agency's conducting a more thorough examination of a subject.

CONCLUSION

The judgment of the court below should be affirmed.

Respectfully submitted,

WILLIAM R. MALONE
One Stamford Forum
Stamford, Ct. 06904-9500
(203) 965-2231

Counsel for GTE Service Corporation and its affiliated domestic telephone operating companies

Of Counsel:

RICHARD MCKENNA*
One Stamford Forum
Stamford, Ct. 06904-9500

JAMES R. HOBSON
1850 M Street, N.W., Suite 1200
Washington, D.C. 20036

PHILIP A. LACOVARA
Hughes Hubbard & Reed
1201 Pennsylvania Avenue, N.W.
Washington, D.C. 20004

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*Counsel of Record

Statutory Appendix

I. ESCH-CUMMINGS ACT (Transportation Act of 1920)

TITLE IV — AMENDMENTS TO INTERSTATE COMMERCE ACT

SEC. 400. The first four paragraphs of section 1 of the Interstate Commerce Act, as such paragraphs appear in section 7 of the Commerce Court Act, are hereby amended to read as follows:

* * *

"(1) That the provisions of this Act shall apply to common carriers engaged in —

* * *

"(c) The transmission of intelligence by wire or wireless; — from one State or Territory of the United States, or the District of Columbia, to any other State or Territory of the United States, or the District of Columbia, or from one place in a Territory to another place in the same Territory, or from any place in the United States through a foreign country to any other place in the United States, or from or to any place in the United States to or from a foreign country, but only in so far as such transportation or transmission takes place within the United States.

"(2) The provisions of this Act shall so apply to such transportation of passengers and property and transmission of intelligence, but only in so far as such transportation or transmission takes place within the United States, but shall not apply —

* * *

"(b) To the transmission of intelligence by wire or wireless wholly within one State and not transmitted to or from a foreign country from or to any place in the United States as aforesaid;

* * *

"(3) The term 'common carrier' as used in this Act shall include all pipe-line companies, telegraph, telephone, and cable companies operating by wire or wireless: Wherever the word 'carrier' is used in this Act it shall be held to mean 'common carrier.' ... The term 'transmission' as used in this Act shall include the transmission of intelligence through the application of electrical energy or other

use of electricity, whether by means of wire, cable, radio apparatus, or other wire or wireless conductors or appliances, and all instrumentalities and facilities for and services in connection with the receipt, forwarding, and delivery of messages, communications, or other intelligence so transmitted, hereinafter also collectively called messages. ***"

(41 Stat. 474-75.)

* * *

SEC. 435. The fifth paragraph of section 20 of the Interstate Commerce Act is hereby amended to read as follows:

"(5) The Commission may, in its discretion, prescribe the forms of any and all accounts, records, and memoranda to be kept by carriers subject to the provisions of this Act, including the accounts, records, and memoranda of the movement of traffic, as well as of the receipts and expenditures of moneys. The Commission shall, as soon as practicable, prescribe, for carriers subject to this Act, the classes of property for which depreciation charges may properly be included under operating expenses, and the percentages of depreciation which shall be charged with respect to each of such classes of property, classifying the carriers as it may deem proper for this purpose. The Commission may, when it deems necessary, modify the classes and percentages so prescribed. The carriers subject to this Act shall not charge to operating expenses any depreciation charges on classes of property other than those prescribed by the Commission, or charge with respect to any class of property a percentage of depreciation other than that prescribed therefor by the Commission. No such carrier shall in any case include in any form under its operating or other expenses any depreciation or other charge or expenditure included elsewhere as a depreciation charge or otherwise under its operating or other expenses. The Commission shall at all times have access to all accounts, records, and memoranda, including all documents, papers, and correspondence now or hereafter existing, and kept or required to be kept by carriers subject to this Act, and the provisions of this section respecting the preservation and destruction of books, papers, and documents shall apply

thereto, and it shall be unlawful for such carriers to keep any other accounts, records, or memoranda than those prescribed or approved by the Commission, and it may employ special agents or examiners who shall have authority under the order of the Commission to inspect and examine any and all accounts, records, and memoranda, including all documents, papers, and correspondence now or hereafter existing, and kept or required to be kept by such carriers. This provision shall apply to receivers of carriers and operating trustees. The provisions of this section shall also apply to all accounts, records, and memoranda, including all documents, papers, and correspondence now or hereafter existing, kept during the period of Federal control, and placed by the President in the custody of carriers subject to this Act."

(41 Stat. 493-94.)

II. COMMUNICATIONS ACT OF 1934

P.L. 416 (73d Cong., 2d Sess.)

APPLICATION OF ACT

SEC. 2. (a) The provisions of this Act shall apply to all interstate and foreign communication by wire or radio and all interstate and foreign transmission of energy by radio, which originates and/or is received within the United States, and to all persons engaged within the United States in such communication or such transmission of energy by radio, and to the licensing and regulating of all radio stations as hereinafter provided; but it shall not apply to persons engaged in wire or radio communication or transmission in the Philippine Islands or the Canal Zone, or to wire or radio communication or transmission wholly within the Philippine Islands or the Canal Zone.

(b) Subject to the provisions of section 301, nothing in this Act shall be construed to apply or to give the Commission jurisdiction with respect to (1) charges, classifications, practices, services, facilities, or regulations for or in connection with intrastate communication service of any carrier, or (2) any carrier engaged in interstate or foreign communication solely through physical connection with the facilities of another carrier not directly or indirectly controlling or controlled by, or under direct or indirect

common control with, such carrier; except that sections 201 to 205 of this Act, both inclusive, shall, except as otherwise provided therein, apply to carriers described in clause (2).

(48 Stat. 1064.)

U.S. Code, Title 47: Telegraphs, Telephones, and Radiotelegraphs.

TITLE I — General Provisions

§ 151. Purposes of Act, Creation of Federal Communications Commission

For the purpose of regulating interstate and foreign commerce in communication by wire and radio so as to make available, so far as possible, to all the people of the United States a rapid, efficient, Nation-wide, and world-wide wire and radio communication service with adequate facilities at reasonable charges, for the purpose of the national defense, for the purpose of promoting safety of life and property through the use of wire and radio communication, and for the purpose of securing a more effective execution of this policy by centralizing authority heretofore granted by law to several agencies and by granting additional authority with respect to interstate and foreign commerce in wire and radio communication, there is hereby created a commission to be known as the "Federal Communications Commission," which shall be constituted as hereinafter provided, and which shall execute and enforce the provisions of this Act.

(June 19, 1934, ch 652, Title I, § 1, 48 Stat. 1064; May 20, 1937, ch 229, § 1, 50 Stat. 189.)

§ 152. Application of the Act

(a) The provisions of this Act shall apply to all interstate and foreign communication by wire or radio and all interstate and foreign transmission of energy by radio, which originates and/or is received within the United States, and to all persons engaged within the United States in such communication or such transmission of energy by radio, and to the licensing and regulating of all radio stations as hereinafter provided; but it shall not

apply to persons engaged in wire or radio communication or transmission in [the Philippine Islands or] the Canal Zone, or to wire or radio communication or transmission wholly within [the Philippine Islands or] the Canal Zone. The provisions of this Act shall apply with respect to cable service, to all persons engaged within the United States in providing such service, and to the facilities of cable operators which relate to such service, as provided in title VI.

(b) Except as provided in section 224 and subject to the provisions of section 301, nothing in this Act shall be construed to apply or to give the Commission jurisdiction with respect to (1) charges, classifications, practices, services, facilities, or regulations for or in connection with intrastate communication service by wire or radio of any carrier, or (2) any carrier engaged in interstate or foreign communication solely through physical connection with the facilities of another carrier not directly or indirectly controlling or controlled by, or under direct or indirect common control with such carrier, or (3) any carrier engaged in interstate or foreign communication solely through connection by radio or by wire and radio, with facilities, located in an adjoining State or in Canada or Mexico (where they adjoin the State in which the carrier is doing business), of another carrier not directly or indirectly controlling or controlled by, or under direct or indirect common control with such carrier, or (4) any carrier to which clause (2) or clause (3) would be applicable except for furnishing interstate mobile radio communication service or radio communication service to mobile stations on land vehicles in Canada or Mexico; except that sections 201 through 205 of this Act, both inclusive, shall, except as otherwise provided therein, apply to carriers described in clauses (2), (3), and (4).

(June 19, 1934, ch 652, Title I, § 2, 48 Stat. 1064; Apr. 27, 1954, ch 175, § 1, 68 Stat. 63; Feb. 21, 1978, P. L. 95-234, § 5, 92 Stat. 35; Oct. 30, 1984, P.L. 98-549, § 3(a)(1), (2), 98 Stat. 2801.)

§ 153. Definitions

For the purposes of this Act, unless the context otherwise requires —

(a) "Wire communication" or "communication by wire" means the transmission of writing, signs, signals, pictures, and sounds of all kinds by aid of wire, cable, or other like connection between the points of origin and reception of such transmission, including all instrumentalities, facilities, apparatus, and services (among other things, the receipt, forwarding, and delivery of communications) incidental to such transmission.

(b) "Radio communication" or "communication by radio" means the transmission by radio of writing, signs, signals, pictures, and sounds of all kinds, including all instrumentalities, facilities, apparatus, and services (among other things, the receipt, forwarding, and delivery of communications) incidental to such transmission.

* * *

(e) "Interstate communication" or "interstate transmission" means communication or transmission (1) from any State, Territory, or possession of the United States (other than the Canal Zone), or the District of Columbia, to any other State, Territory, or possession of the United States (other than the Canal Zone), or the District of Columbia, (2) from or to the United States to or from the Canal Zone, insofar as such communication or transmission takes place within the United States, or (3) between points within the United States but through a foreign country; but shall not, with respect to the provisions of title II of this Act (other than section 223 thereof), include wire or radio communication between points in the same State, Territory, or possession of the United States, or the District of Columbia, through any place outside thereof, if such communication is regulated by a State commission.

* * *

(June 19, 1934, ch. 652, Title I, § 3, 48 Stat. 1065; Apr. 27, 1954, ch. 175, §§ 2, 3, 68 Stat. 64; May 3, 1968, P. L. 90-299, § 2, 82 Stat. 112.)

TITLE II — Common Carriers

* * *

§ 220. Accounts, Records, And Memoranda; Depreciation Charges

(a) The Commission may, in its discretion, prescribe the forms of any and all accounts, records, and memoranda to be kept by carriers subject to this Act, including the accounts, records, and memoranda of the movement of traffic, as well as of the receipts and expenditures of moneys.

(b) The Commission shall, as soon as practicable, prescribe for such carriers the classes of property for which depreciation charges may be properly included under operating expenses, and the percentages of depreciation which shall be charged with respect to each of such classes of property, classifying the carriers as it may deem proper for this purpose. The Commission may, when it deems necessary, modify the classes and percentages so prescribed. Such carriers shall not, after the Commission has prescribed the clasess [classes] of property for which depreciation charges may be included, charge to operating expenses any depreciation charges on classes of property other than those prescribed by the Commission, or, after the Commission has prescribed percentages of depreciation, charge with respect to any class of property a percentage of depreciation other than that prescribed therefor by the Commission. No such carrier shall in any case include in any form under its operating or other expenses any depreciation or other charge or expenditure included elsewhere as a depreciation charge or otherwise under its operating or other expenses.

(c) The Commission shall at all times have access to and the right of inspection and examination of all accounts, records, and memoranda, including all documents, papers, and correspondence now or hereafter existing, and kept or required to be kept by such carriers, and the provisions of this section respecting the preservation and destruction of books, papers, and documents shall apply thereto. The burden of proof to justify every accounting entry questioned by the Commission shall be

on the person making, authorizing, or requiring such entry and the Commission may suspend a charge or credit pending submission of proof by such person. Any provision of law prohibiting the disclosure of the contents of messages or communications shall not be deemed to prohibit the disclosure of any matter in accordance with the provisions of this section.

(d) In case of failure or refusal on the part of any such carrier to keep such accounts, records, and memoranda on the books and in the manner prescribed by the Commission, or to submit such accounts, records, memoranda, documents, papers, and correspondence as are kept to the inspection of the Commission or any of its authorized agents, such carrier shall forfeit to the United States the sum of $500 for each day of the continuance of each such offense.

(e) Any person who shall willfully make any false entry in the accounts of any book of accounts or in any record or memoranda kept by any such carrier, or who shall willfully destroy, mutilate, alter, or by any other means or device falsify any such account, record, or memoranda, or who shall willfully neglect or fail to make full, true, and correct entries in such accounts, records, or memoranda of all facts and transactions appertaining to the business of the carrier, shall be deemed guilty of a misdemeanor, and shall be subject, upon conviction, to a fine of not less than $1,000 nor more than $5,000 or imprisonment for a term of not less than one year nor more than three years, or both such fine and imprisonment: *Provided,* That the Commission may in its discretion issue orders specifying such operating, accounting, or financial papers, records, books, blanks, or documents which may, after a reasonable time, be destroyed, and prescribing the length of time such books, papers, or documents shall be preserved.

* * *

(g) After the Commission has prescribed the forms and manner of keeping of accounts, records, or memoranda to be kept by any person as herein provided, it shall be unlawful for such person to keep any other accounts, records, or memoranda than those so prescribed or such as

may be approved by the Commission or to keep the accounts in any other manner than that prescribed or approved by the Commission. Notice of alterations by the Commission in the required manner or form of keeping accounts shall be given to such persons by the Commission at least six months before the same are to take effect.

(h) The Commission may classify carriers subject to this Act and prescribe different requirements under this section for different classes of carriers, and may, if it deemed such action consistent with the public interest, except the carriers of any particular class or classes in any State from any of the requirements under this section in cases where such carriers are subject to State commission regulation with respect to matters to which this section relates.

(i) The Commission, before prescribing any requirements as to accounts, records, or memoranda, shall notify each State commission having jurisdiction with respect to any carrier involved, and shall give reasonable opportunity to each such commission to present its views, and shall receive and consider such views and recommendations.

(j) The Commission shall investigate and report to Congress as to the need for legislation to define further or harmonize the powers of the Commission and of State commissions with respect to matters to which this section relates.

(June 19, 1934, ch 652, Title II, § 220, 48 Stat. 1078.)

§ 221. Special Provisions Relating to Telephone Companies

* * *

(b) Subject to the provisions of section 301, nothing in this Act shall be construed to apply, or to give the Commission jurisdiction, with respect to charges, classifications, practices, services, facilities, or regulations for or in connection with wire, mobile, or point-to-point radio telephone exchange service, or any combination thereof, even though a portion of such exchange service constitutes interstate or foreign communication, in any case where such matters are subject to regulation by a State commission or by local governmental authority.

(c) For the purpose administering this Act as to carriers engaged in wire telephone communication, the Commission may classify the property of any such carrier used for wire telephone communication, and determine what property of said carrier shall be considered as used in interstate or foreign telephone toll service. Such classification shall be made after hearing, upon notice to the carrier, the State commission (or the Governor, if the State has no State commission) of any State in which the property of said carrier is located, and such other persons as the commission may prescribe.

* * *

(June 19, 1934, ch 652, Title II, § 221, 48 Stat. 1080; Apr. 27, 1954, ch 175, § 4, 68 Stat. 64.)

§ 604 [47 U.S.C. § 704]. Effect of Transfers, Repeals and Amendments

(a) All orders, determinations, rules, regulations, permits, contracts, licenses, and privileges which have been issued, made, or granted by the Interstate Commerce Commission, the Federal Radio Commission, or the Postmaster General, under any provision of law repealed or amended by this Act or in the exercise of duties, powers, or functions transferred to the Commission by this Act, and which are in effect at the time this section takes effect, shall continue in effect until modified, terminated, superseded, or repealed by the Commission or by operation of law.

(b) Any proceeding, hearing, or investigation commenced or pending before the Federal Radio Commission, the Interstate Commerce Commission, or the Postmaster General, at the time of the organization of the Commission, shall be continued by the Commission in the same manner as though originally commenced before the Commission, if such proceeding, hearing, or investigation (1) involves the administration of duties, powers, and functions transferred to the Commission by this Act, or (2) involves the exercise of jurisdiction similar to that granted to the Commission under the provisions of this Act.

(c) All records transferred to the Commission under this Act shall be available for use by the Commission to

the same extent as if such records were originally records of the Commission. All final valuations and determinations of depreciation charges by the Interstate Commerce Commission with respect to common carriers engaged in radio or wire communication, and all orders of the Interstate Commerce Commission with respect to such valuations and determinations, shall have the same force and effect as though made by the Commission under this Act.

(June 19, 1934, ch 652, Title VII[VI], § 704[604], 48 Stat. 1103; Oct. 30, 1984, P. L. 98-549, § 6(a), 98 Stat. 2804.)

APPENDIX II

LEGISLATIVE CHRONOLOGY OF SECTIONS 2(b) AND 220 OF THE COMMUNICATIONS ACT OF 1934 AND THEIR ANTECEDENTS

This appendix traces chronologically from their inceptions the evolution of the Section 2(b)(1) exemption and the depreciation provisions of the 1934 Act.

6/18/10 The Mann-Elkins Act, 36 Stat. 539, 544-45, 555, amended Section 1 of the Interstate Commerce Act of 1887 to make it applicable to all telephone companies, subject to the proviso that the act should not apply to intrastate transmissions.

1/1/13 The ICC's "Uniform System of Accounts for Telephone Companies," became effective, requiring telephone companies to include depreciation charges in operating expenses under authority of Section 20(5) of the act, as added in the Hepburn Act of 1906, 34 Stat. 584, 595.

6/8/14 The Court held in the *Shreveport Rate Case* that the intrastate proviso in Section 1 did not prevent the ICC from ordering intrastate rates raised to eliminate discrimination against interstate commerce.

1919, 1922-27 NARUC's annual meetings in 1919 and 1922-27 passed resolutions urging Congress to restrict ICC jurisdiction over telephone companies to primarily interstate commerce.

2/28/20 The Esch-Cummings Act (Transportation Act of 1920), 41 Stat. 456, amended Section 20(5) to require the ICC to establish, and the carriers to comply with, schedules of depreciation for all classes of property. It also amended the form of Section 1 of the act to make the act applicable to telephone companies engaged in interstate transmission, but provided that the

act should not apply to intrastate transmissions. Finally, Congress added provisions in Section 13 of the act permitting the ICC to consult with, or hold joint hearings with, state commissions on *Shreveport* cases.

12/6/23 NARUC's annual convention adopted the following resolution on the jurisdiction given the ICC by the Esch-Cummings Act:

> RESOLUTION RELATING TO TELEPHONE DEPRECIATION
>
> *Be It Resolved* by this Association, that the Committee on State and Federal Legislation be instructed to take such action as may be required to secure the amendment of the Interstate Commerce Act so that the jurisdiction to fix the depreciation charges, by telephone companies, shall clearly rest with the various state commissions, as it did prior to the enactment of the Transportation Act of 1920.

NARUC: 1923 Proceedings at 302; printed in 1934 Senate Hearings at 184.

4/18/29 Sen. Couzens (R-Mich.) introduced S. 6 to establish a commission on communications, largely carrying over the provisions of Sections 1, 13, and 20(5) of the Commerce Act.

8/29/29 NARUC's annual convention adopted a resolution opposing enactment of S. 6. 1929 Proceedings at 423.

1/30/30 At Hearings on S. 6 before the Senate Commerce Committee, Walter S. Gifford, President of AT&T, testified in pertinent part:

> Let us take the present situation. The Interstate Commerce Commission is supposed to regulate only interstate business. As a matter of fact. . . . the present regulation is such that all the accounts of all of our companies are kept in accordance with Federal regulations laid down by the Interstate Commerce Commission. Our records are destroyed according to the regulations laid down by the Interstate Commerce Commission. The Interstate Commerce Commission is engaged in fixing our rates of depreciation.

Loc. cit. at 1990; *cf. id.* at 2027, 2029-30, 2051; testimony of F. B. MacKinnon, President of USITA, at 2119; testimony of Charles C. Dearing, Secretary of USITA, at 2139-40 (2/3/30).

2/5/30 Later in the Senate hearings, John E. Benton, General Solicitor of NARUC, recited NARUC's opposition to the depreciation provisions of the Esch-Cummings Act, starting with the 1923 resolution, and presented similar resolutions from thirty-seven states. *Loc. cit.* at 2215, 2224-31, 2170, 2168, 2178, 2222-23, 2232-85. The ICC's exercise of its authority under the 1920 amendments to Section 20 of the Interstate Commerce Act, he said, "would result in the practical destruction of State regulatory powers." *Id.* at 2179.

4/23/30 A confidential committee print of the redrafted Couzens bill, S. 6, contained in Section 1 (Application of the Act) the language which became Section 2(a) of the 1934 Act through the second "to" clause, but added in Section 65 (Investigations and Orders as to Rates and Practices) paragraph (d) withholding from the new commission the authority to regulate intrastate rates, "whether for the purpose of removing discrimination against interstate commerce or for any other purpose." Section 69(b) of the bill tracked Section 20(5) of the Commerce Act, and Section 110 directed the ICC to complete "the determination of percentages of depreciation charges" for all telephone companies.

2/26/34 At Senator Dill's request, President Roosevelt sent to Congress a message calling for the consolidation of Federal authority over communications in a new commission. S. Doc. No. 144 (73d Cong., 2d Sess.); 78 *Cong. Rec.* 3259.

2/27/34 Companion bills, S. 2910 and H.R. 8301, were introduced in the Senate and House by Senator Dill and Congressman Rayburn, respectively, "centralizing authority heretofore granted by law to several agencies and ... granting additional authority" in and to the FCC (§ 1). Section 2 (Application of Act) tracks Section 1 from the revised Couzens bill. Both bills contained the following exclusion, adapted from Section 1(2) of the Commerce act as amended in 1920:

> ACT NOT TO APPLY TO COMMUNICATION IN INTRASTATE COMMERCE
>
> Sec. 210. Nothing in this Act shall be construed to apply, or to give the Commission jurisdiction, with respect to charges, classifications, practices, or regulations for or in connection with intrastate communication service of any carrier, or to any carrier engaged exclusively in intrastate commerce.

Both bills contained the language on accounting and depreciation from Section 20(5) of the Commerce act and in addition three paragraphs (h), (i) and (j), proposed by the state commissions. Paragraphs (h) and (i) were essentially as enacted in 1934. Paragraph (j) read as follows:

> (j) Nothing in this section shall (1) limit the power of a State commission to prescribe, for the purposes of the exercise of its jurisdiction with respect to any carrier, the percentage rate of depreciation to be charged to any class of property of such carrier, or the composite depreciation rate, for the purpose of determining charges, accounts, records, or practices; or (2) relieve any carrier from keeping any accounts, records, or memoranda which may be required to be kept by any State commission in pursuance of authority granted under State law.

March, 1934 At the Senate hearings on S. 2910, President Gifford of AT&T attacked paragraphs (h), (i), and (j) as inconsistent with existing practice under Section 20(5) of the Commerce Act, *loc. cit.* at 95-96, as did USITA's President MacKinnon. *Id.* at 139-40.

The following day NARUC's witness, Kit F. Clardy of the Michigan commission, characterized the language of those paragraphs as having been worked out by the State commissions to prevent them from being "entirely ousted from their jurisdiction" by *Shreveport*. *Loc. cit.* at 154-55.

The succeeding day NARUC Solicitor Benton, acknowledging that the "ICC has had power over depreciation since 1920", *id.* at 181, attributed the addition of paragraphs (h)-(j) to "representations which were made by State Commission representatives." *Id.* at 180. On this point, the following colloquy between Senator Dill, presiding, and Senator Long (D-La.) confirmed Benton's statement as to origin:

> *The Chairman.* I may say, Senator Long, that at the request of the State commission representatives, we wrote in certain provisions that are not in the Interstate Commerce Act, to protect the State commissions against being overridden by this Commission, as the Interstate Commission has overridden some of the railroad State commissions.
>
> *Senator Long.* We do not want to give them what they call the right to slip in on the ground of intrastate discriminations against interstate business.
>
> *The Chairman.* Protection against the Shreveport decision.
>
> *Senator Long.* Yes.

Id. at 179. "There ought not be", Benton testified, "a transfer to the new commission of the exact powers which the Interstate Commerce Commission now possesses over telephone companies." *Id.* at 180.

The next day in a letter to Senator Dill, ICC Commissioner McManamy cautioned with respect to paragraphs (h)-(j):

> The last three paragraphs are new.
>
> Paragraph (j) of these new paragraphs should be most carefully considered. It unquestionably directly conflicts with, and destroys the uniformity of systems of accounts and depreciation accounting required by the preceding provisions of the section. That is not true under the present law. In this connection consideration should also be given to the last 4 lines of paragraph (h).

Id. at 208; printed also in House hearings on H.R. 8301, May 8, 1934, at 96.

4/4/34 Senator Dill introduced a clean bill, S. 3285, which transposed the Section 210 language of S. 2910 and H.R. 8301 to Section 2(b) and amended paragraphs (h) and (j) of Section 220 to read as follows:

> (h) The Commission may classify carriers subject to this Act and prescribe different requirements under this section for different classes of carriers.
>
> * * *
>
> (j) The Commission shall investigate and report to the Congress whether in its opinion legislation is desirable (1) authorizing the Commission to except the carriers of any particular class or classes in any State from any of the requirements under this section in cases where such carriers are subject to State commission regulation with respect to matters to which this section relates; and (2) permitting the State commissions, in pursuance of authority granted under State law, to prescribe their own percentage rates of depreciation or systems of accounts, records, or memoranda to be kept by carriers.

4/10/34 Dr. Irwin Stewart, a member of the Interdepartmental Committee on Communications whose report underlay President Roosevelt's message to Congress calling for communications legislation, testified before the House committee:

> Section 220, I believe, will also be the subject of considerable discussion before your committee. The first paragraphs, that is, through paragraph (g), are taken from the Interstate Commerce Act, which give to the Interstate Commerce Commission the right to prescribe uniform accounting, to fix depreciation charges, and makes those provisions the only provisions on the subject. That is, it takes away any jurisdiction that the State may have had.

> ...[P]aragraphs (h), (i), and (j), are new material which would leave to the State commissions certain authority over the subject matter.

Loc. cit. at 17.

4/11/34 At the House hearings on H.R. 8301 NARUC's lead-off witness, Kit F. Clardy, acknowledged that under the Commerce Act

> if the present power now given to the Interstate Commerce Commission should be exercised up to the hilt, we would not only be Shreveported out of control, but we would be checked and double-checked. We would be right out of the [telephone and telegraph] field entirely.

Loc. cit. at 74. Attacking the redrafting in S. 3285 as "perhaps result[ing] in the crippling of State regulation of accounts and depreciation in a very vital way", Clardy asserted: "[I]t substantially cuts us from our jurisdiction." *Id.* at 70, 73.

5/9/34 Later in the same hearings, NARUC Solicitor Benton conceded that

> The Interstate Commerce Commission has the same power now to override State regulation in the telephone field as it has in the railroad field....

Op. cit. at 135-36. The House bill as drafted, he said, "removes provisions of the law which are now existent" depriving the State commissions of authority over such matters as depreciation. Id. at 139. Pointing specifically to the differences between the paragraphs (h) and (j) of H.R. 8301 and S. 3285, Benton said:

> I assume that the committee which drafted this bill had that redraft [of S. 6 (71st Cong., 1st Sess.)]. Certain provisions which were in it have been carried into this bill. The State commissions were also permitted to file a brief in that connection, and that undoubtedly was considered in the preparation of this bill, H.R. 8301, which is before this committee. This bill has been drafted to safeguard State powers and to leave State commissions power to regulate intrastate business unhampered.
>
> The Senate redraft, however, seems to have shown response to a very vigorous attack made upon the accounting sections by President Gifford before the Senate committee.

Id. at 140.

NARUC suggested two amendments to Subsections (a) and (b) of Section 220 of H.R. 8301 "to avoid conflict" between each of those subsections and Subsection (j). The first amendment would have removed the phrase "any and all" from Subsection (a), and the second would have restricted the binding effect of the FCC's depreciation prescriptions to "the accounts prescribed by the Commission." *Id.* at 144. (Although both of these suggested amendments were reported by the House committee, neither they nor NARUC's Subsection (j) survived conference.)

4/19/34 S. 3285 was reported by the Senate Committee with no further amendments to Sections 2(b) and 220(b) and (h)-(j). The Senate Report to accompany S. 3285 stated:

> Section 220 (a-g) is taken from section 20 (5-8) of the Interstate Commerce Act dealing with accounts, records, and memoranda. It also adds the new provisions found in subsections (h), (i), and (j). Subsections (h) and (i) reflect the present practice of the Interstate Commerce Commission. Subsection (j) is responsive to the recommendations of the State public utilities commissions, except that it calls for investigation and report to Congress instead of immediately turning over these matters to the State.

Loc. cit. at 5. The report also noted that under Section 220 the new commission was directed to investigate the "desirability of permitting State regulation of . . . rates of depreciation charges . . ." *Id.* at 2.

5/10/34 Upon resumption of the House hearings, Gifford of AT&T repeated his Senate testimony critical of provisions of H.R. 8301 that would change the current law and practice with respect to uniform accounting and depreciation systems. Asked by Congressman Mapes (R-Mich.) whether the States required AT&T "to keep accounts of any kind," Gifford replied: "No. The present law, the interstate commerce law, calls for accounts and that controls, as against the State laws." *Loc. cit.* at 192. MacKinnon of USITA again testified in favor of uniform accounting, depreciation, and valuation. *Id.* at 240-46.

5/15/34 S. 3285 was passed by the Senate. Section 2(b) was amended on the floor on motion of Senator (later Judge) "Champ" Clark (D-Missouri) to further protect the small Independents, by deleting "wire" and revising the final clause to read:

> or to any carrier engaged in interstate or foreign communication solely through physical connection with the facilities of another carrier not directly or indirectly controlling or controlled by such carrier, or under direct or indirect control with such other carrier.

78 Cong. Rec. 8846.

6/1/34 S. 3285, as unanimously reported by the House Commerce Committee, essentially substituted H.R. 8301 for S. 3285, amending Section 2(b) to reference Sections 301 and 201-05 and reverting to the original language of Section 220(h)-(j) in S. 2910 and H.R. 8301, as introduced.

The House report (H. Rpt. No. 1850) contains the following explanation:

> (2) The Senate bill includes an amendment adopted on the floor of the Senate exempting carriers engaged in interstate or foreign communication solely through physical connection with the facilities of a nonaffiliated carrier. The amendment retains this provision except that it makes such carriers subject to sections 201 and 205, providing for regulation of charges and prohibiting discriminations. Such carriers will not, however, be required to file schedules of charges. [p. 2]
>
> * * *
>
> Section 2 makes the bill applicable to all interstate and foreign communication by wire or radio, except that independent telephone companies engaged in interstate or foreign communication only through physical connections with another nonaffiliated carrier are subjected only to certain sections of the act designed to insure reasonableness of rates and no discrimination in service. The bill also exempts the intrastate business of any carrier. [p. 4]

* * *

Section 220 (a-g) is taken from section 20 (5-8) of the Interstate Commerce Act dealing with accounts, records, and memoranda. It also adds the new provisions found in subsections (h), (i), and (j). Subsections (h), (i), and (j) are responsive to the requests of the State commissions that the present law be changed so as to permit those bodies to exercise, for State purposes, certain jurisdiction over accounting systems and methods of depreciation accounting. [p. 7]

6/2/34 Chairman Rayburn opened debate on the bill with the following statement:

Section 2 (b) exempts from most of the provisions of the act small independent telephone companies whose only interstate business is through physical connection with a nonaffiliated company. The sections to which such independent companies are subjected are those providing for the regulation of rates and prohibiting unjust discrimination in interstate and foreign service.

* * *

Section [2]20, paragraphs (a) to (g), relating to accounts records, memoranda, and depreciation is based upon section 20 (5-8) of the Interstate Commerce Act with changes necessary to permit State commissions to prescribe the systems of accounts for the intrastate operation of carriers. Paragraphs (h) to (j) are new. Paragraph (h) authorizes the commission to classify carriers and to except the carriers of particular classes in any State from the requirements of the section where the State commission regulates accounts or depreciation for the particular class of carriers. Paragraph (i) requires the commission to consult the State commission before prescribing new systems of accounts and paragraph (j) removes any limitation upon the power of a State commission to prescribe, for the purposes of the exercise of its jurisdiction, rates of depreciation. The last three paragraphs named were placed in the bill at the request of the State commissions which feel that their task of regulating intrastate communications will be greatly facilitated by the adoption of these paragraphs.

78 Cong.Rec. 10313, 10314.

The bill passed the House by a voice vote and went to conference.

6/8/34 The Conference committee made no changes in Section 2(b), as passed by the House. The language concerning the FCC's power to except classes of carriers in the States from Federal prescriptions reverted to Section 220(h), and the language of (j) was cut back to a requirement that the Commission report to Congress on the harmonization of Federal and state powers in accounting and depreciation matters. The conforming House amendments to Sections 220(a) and (b) were also eliminated. The statement of the House managers reads in pertinent part:

Appendix II

Section 220 (j) of the Senate bill (relating to accounts and depreciation charges) authorizes the Commission to investigate and report to Congress upon the desirability of legislation authorizing the Commission to except the carriers of any particular class or classes in any State from the requirements of the section and permitting State commissions to prescribe their own percentage rates of depreciation and systems of accounts for carriers. The House amendment (sec. 220 (h)) specifically authorizes the Commission to except carriers of any particular class or classes in any State and provides (in sec. 220 (j)) that the section shall not limit the power of the State commissions to prescribe percentage rates of depreciation or to require the keeping of accounts. The substitute adopts the House provision as to exception of particular classes of carriers and a modified provision for investigation and report to Congress as to the need for defining or harmonizing Federal and State authority in respect of other matters to which the section relates.

H. Rept. No. 1918 at 47; 78 Cong. Rec. 10987.

6/9/34 The conference report (H. Rept. No. 1918, dated June 8, 1934) passed the Senate without debate and passed the House 58-40.

6/19/34 P.L. 416 (73d Cong., 2d Sess.) was signed by the President.

APPENDIX III

COMPARATIVE ANALYSIS OF SECTION 20(5) OF THE INTERSTATE COMMERCE ACT AND SECTION 220(a), (b) OF THE COMMUNICATIONS ACT

Interstate Commerce Act[1]	Communications Act[2]
(5) The Commission may, in its discretion, prescribe the forms of any and all accounts, records, and memoranda to be kept by carriers subject to the provisions of this Act, including the accounts, records, and memoranda of the movement of traffic, as well as of the receipts and expenditures of moneys.	SEC. 220. (a) The Commission may, in its discretion, prescribe the forms of any and all accounts, records, and memoranda to be kept by carriers subject to this Act, including the accounts, records, and memoranda of the movement of traffic, as well as of the receipts and expenditures of moneys.
The Commission shall, as soon as practicable, prescribe for carriers subject to this Act, the classes of property for which depreciation charges may properly be included under operating expenses, and the percentages of depreciation which shall be charged with respect to each of such classes of property, classifying the carriers as it may deem proper for this purpose. The Commission may, when it deems necessary, modify the classes and percentages so prescribed. The carriers subject to this Act shall not	(b) The Commission shall, as soon as practicable, prescribe for such carriers the classes of property for which depreciation charges may be properly included under operating expenses, and the percentages of depreciation which shall be charged with respect to each of such classes of property, classifying the carriers as it may deem proper for this purpose. The Commission may, when it deems necessary, modify the classes and percentages so prescribed. Such carriers shall not,
	after the Commission has prescribed the clasess [classes] of property for which depreciation charges may be included,
charge to operating expenses any depreciation charges on classes of property other than those prescribed by the Commission, or	charge to operating expenses any depreciation charges on classes of property other than those prescribed by the Commission, or, after the Commission has prescribed percentages of depreciation,
charge with respect to any class of property a percentage of depreciation other than that prescribed therefor by the Commission. No such carrier shall in any case include in any form under its operating or other expenses any depreciation or other charge or expenditure included elsewhere as a depreciation charge or otherwise under its operating or other expenses. * * *	charge with respect to any class of property a percentage of depreciation other than that prescribed therefor by the Commission. No such carrier shall in any case include in any form under its operating or other expenses any depreciation or other charge or expenditure included elsewhere as a depreciation charge or otherwise under its operating or other expenses.

1. As amended by Section 435 of the Esch-Cummings Act (Transportation Act of 1920), 41 Stat. 493.

2. P.L. 416 (73d Cong., 2d Sess.), as approved by the President on June 19, 1934.

APPENDIX IV

LIST OF PRINCIPAL GTE SUBSIDIARIES PURSUANT TO RULE 28.1

In compliance with the Court's Rule 28.1, following is a listing of the parent company and all principal subsidiaries of the GTE parties in this Court:

GTE CORPORATION

- GTE Service Corporation
- GTE Products of Connecticut Corporation
  - GTE Government Systems Corporation
  - GTE Communication Systems Corporation
  - GTE Products Corporation
  - GTE Laboratories Incorporated
  - GTE International Incorporated
    - GTE Telecomunicazioni S.p.A.
    - GTE Sylvania Licht, GmbH
    - GTE ATEA N.V. - S.A.
- GTE Communications Services Incorporated
  - GTE Sprint Communications Corporation
  - GTE Satellite Corporation
  - GTE Spacenet Corporation
  - GTE Telenet Incorporated
    - GTE Telenet Holding Corporation
    - GTE Support Services Incorporated
  - GTE TeleMessager Incorporated
- GTE Valeron Corporation
- Anglo-Canadian Telephone Company
  - British Columbia Telephone Company
    - Microtel Limited
    - Canadian Telephones and Supplies Ltd.
  - Dominion Directory Company Limited
  - Compania Dominicana de Telefonos, C. por A.
  - Quebec - Telephone
- General Telephone Company of Alaska
- General Telephone Company of California
- General Telephone Company of Florida
- General Telephone Company of Illinois

Appendix IV

General Telephone Company of Indiana, Inc.
General Telephone Company of Kentucky
General Telephone Company of Michigan
General Telephone Company of the Midwest
General Telephone Company of the Northwest, Inc.
  West Coast Telephone Company of California
General Telephone Company of Ohio
General Telephone Company of Pennsylvania
General Telephone Company of the Southeast
General Telephone Company of the Southwest
General Telephone Company of Wisconsin
Hawaiian Telephone Company
  The Micronesian Telecommunications Corporation
GTE Directories Corporation
GTE Data Services Incorporated
GTE Finance Corporation
  GTE Finance N.V.
  GTE Export Factoring Company B.V.
GTE Global Corporation
GTE Investment Management Corporation
GTE Mobilnet Incorporated
GTE Realty Corporation
GTE Reinsurance Company Limited
GTE Shareholder Services Incorporated
GTE Telecom Incorporated

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Nos. 84-871, 84-889, 84-1054 and 84-1069

IN THE

Supreme Court of the United States

OCTOBER TERM, 1985

LOUISIANA PUBLIC SERVICE COMMISSION,
Appellant,

v.

FEDERAL COMMUNICATIONS COMMISSION and
UNITED STATES OF AMERICA, *et al.*,
Appellees.
(and three consolidated cases)

On Appeal from and On Writs of Certiorari to the United States Court of Appeals for the Fourth Circuit

JOINT BRIEF OF LISTED PRIVATE RESPONDENTS

DONALD MCG. ROSE*
DAVID C. HORN
2500 Central Trust Center
201 East Fifth Street
Cincinnati, OH 45202
(513) 651-6944

Attorneys for Cincinnati Bell Telephone Company

JOHN WOHLSTETTER*
1800 K Street, N.W.
Washington, D.C. 20006
(202) 466-2895

Attorney for Continental Telecom, Inc.

MICHAEL BOUDIN*
CHRISTOPHER T. CURTIS
ELIZABETH V. FOOTE
1201 Pennsylvania Ave., N.W.
P.O. Box 7566
Washington, D.C. 20044
(202) 662-6000

Attorneys for AT&T and the former Bell System Operating Companies (other than Cincinnati Bell Telephone Company, Nevada Bell, and Pacific Bell)

[List of Counsel Continued on Inside Cover]

CAROLYN C. HILL*
1875 Eye Street, N.W.
Washington, D.C. 20006
(202) 659-4600

RONALD T. LEMAY
5454 West 110th Street
P.O. Box 7927
Overland Park, KS 66207
(913) 345-6057

Attorneys for United Telephone System, Inc.

THOMAS J. REIMAN
30 South Wacker Drive
Chicago, IL 60606
(312) 750-5255

ALFRED WINCHELL WHITTAKER
655-15th Street, N.W.
Washington, D.C. 20005
(202) 879-5090

Attorneys for the Ameritech Telephone Companies

LAURENCE W. DEMUTH, JR.
7800 E. Orchard Road
Englewood, CO 80111
(303) 793-6310

DAVID S. SATHER
ROBERT MCKENNA
1020-19th Street, N.W.
Washington, D.C. 20036
(202) 429-0303

Attorneys for Mountain States Telephone and Telegraph Company, Northwestern Bell Telephone Company and Pacific Northwest Bell Telephone Company

SAUL FISHER
500 Westchester Avenue
White Plains, NY 10604
(914) 683-2266

JOHN B. MESSENGER
1828 L Street, N.W.
Washington, D.C. 20036
(202) 955-1170

Attorneys for the NYNEX Telephone Companies

FRANCINE J. BERRY
W. PRESTON GRANBERY
295 North Maple Avenue
Basking Ridge, NJ 07920
(201) 221-3327

Attorneys for AT&T

ALBERT H. KRAMER*
2000 M Street, N.W.
Washington, D.C. 20036
(202) 223-6611

Attorney for North American Telecommunications Association

MARK J. MATHIS
D. MICHAEL STROUD
1710 H Street, N.W.
Washington, D.C. 20006
(202) 392-5111

Attorneys for the Bell Atlantic Telephone Companies

VINCENT L. SGROSSO
675 West Peachtree St., N.E.
Atlanta, GA 30375
(404) 529-8231

Attorney for the BellSouth Telephone Companies

EDGAR MAYFIELD
1010 Pine Street
St. Louis, MO 63101
(314) 247-4995

Attorney for Southwestern Bell Telephone Company

WILLIAM O'KEEFE
227 Church Street
New Haven, CT 06503
(203) 771-8818

Attorney for the Southern New England Telephone Company

November 1985

**Counsel of Record*

QUESTIONS PRESENTED

1. Did the Federal Communications Commission correctly construe Section 220 of the Communications Act, 47 U.S.C. § 220, to make the FCC's depreciation rules and prescriptions for telephone plant used interchangeably in interstate and intrastate communication binding in state proceedings involving the same telephone plant?

2. Alternatively, did the FCC lawfully preempt inconsistent state regulation of depreciation where (a) the FCC rationally found that preemption was necessary to avoid frustration of federal policy and (b) inconsistent state regulation conflicted with federal rules lawfully adopted by the FCC?

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JOINT BRIEF OF LISTED PRIVATE RESPONDENTS

This brief is filed on behalf of 26 private parties who supported the Federal Communications Commission in the court below.[1] The position of this brief is that the Fourth Circuit's judgment is correct and should be affirmed.

STATEMENT OF FACTS

In 1980 and 1981, the Federal Communications Commission made substantive changes in its rules for determining depreciation of telephone plant in the United States which is used in common for interstate and intrastate communication.

[1] The names of the subscribing parties are set forth in Appendix A together with cross-references to information required by S. Ct. R. 28.1. The subscribing parties include telephone companies providing about 75 percent of the local telephone service in the United States.

Thereafter, the FCC ruled in 1983 that it would violate the Communications Act[2] for individual states to order telephone companies to depreciate the same telephone plant using depreciation rates or methods inconsistent with those adopted by the FCC. Alternatively, the FCC found that such inconsistent state regulation would frustrate federal policy designed to assure timely cost recovery and improved service. The Fourth Circuit upheld the FCC's preemptive decision.

A. The Statutory Plan and the Regulation of Depreciation

Virtually all of the telephone company facilities and equipment ("telephone plant") in the United States used to provide intrastate service is also used to provide interstate service.[3] Whether a call travels across the street or across the United States, it originates in the same telephone set or switchboard, uses the same "inside wiring" in the home or office, and traverses the same line to the switching facilities at the telephone company central office. In short, local telephone plant is used interchangeably for both interstate and intrastate service. From the standpoint of physical facilities, the United States has "a unified system of communication." [4]

Under the Act, the FCC has an overriding mandate "to make available . . . a rapid, efficient, Nation-wide . . . communication service with adequate facilities at reasonable charges." Section 1, 47 U.S.C. § 151. The FCC's jurisdiction under Section 2 of the Act, 47 U.S.C. § 152, and its express statutory powers over telephone companies extend to telephone plant commonly used for interstate and intrastate communication.[5]

[2] Communications Act of 1934 ("the Act"), 47 U.S.C. § 151, *et seq.* Pertinent provisions of the Act are reprinted in Appendix B.

[3] *North Carolina Utils. Comm'n* v. *FCC*, 537 F.2d 787 (4th Cir.), *cert. denied*, 429 U.S. 1027 (1976) (*"NCUC I"*). Some telephone plant may be used only for interstate operation (*e.g.*, a cable connecting two cities in different states) but there is virtually no plant used for intrastate calls that is not also used or usable to carry interstate calls as well.

[4] *General Telephone Company* v. *FCC*, 413 F.2d 390, 401 (D.C. Cir.) (Burger, J.), *cert. denied*, 396 U.S. 888 (1969), affirming the FCC's "central authority" over that unified system.

[5] The provisions of Section 2 of the Act, the relevant definitional provisions, and the express powers are discussed in detail at pp. 32-38, below.

In regulating this commonly used plant, the FCC has repeatedly been sustained in preempting inconsistent state regulation, even though state commissions otherwise retain substantial authority over purely intrastate aspects of service.[6]

Section 220 of the Act, 47 U.S.C. § 220, the provision that lies at the heart of this case, gives the FCC plenary authority to prescribe depreciation for telephone plant for carriers subject to the Act. Depreciation measures the loss of service value of a capital asset over time by allocating the asset's cost, through an annual depreciation expense, to the individual years in which the asset is usefully in service. The depreciation expense is reflected in rates for the services provided by the carrier (although rates are also affected by many other determinations). Because local telephone plant is used for both interstate and intrastate services, the depreciation expense for such plant affects—but does not determine—both interstate and intrastate rates.

To illustrate depreciation, assume that a carrier's line connecting a house with the local central office costs $100 and is expected to last 10 years. The FCC's standard method—"straight line" depreciation—would assign $10 per year as an expense to be recovered through telephone rates for 10 years. In addition, the FCC also has authority to "separate" the expense by allocating a part of the $10 per year to interstate rates and the balance to intrastate rates.[7] Thus, if 25 percent of the line's cost were allocated by the FCC to interstate service and 75 percent to intrastate service, that carrier would be entitled to include each year $2.50 in its interstate revenue requirement and $7.50 each year in its intrastate revenue requirement until the investment had been recovered at the end of ten years. Although depreciation therefore affects rates at both the interstate and intrastate levels, it represents only about 10-15 percent of overall revenue requirements and is only one

[6] The provisions relating to intrastate service (Sections 2(b) and 221(b), 47 U.S.C. §§ 152(b), 221(b)), and the cases construing these provisions in light of the FCC's preemptive authority, are discussed at pp. 31-38, below.

[7] See Sections 221(c) and 410(c) of the Act, 47 U.S.C. §§ 221(c), 410(c), discussed at pp. 14-15, below.

of a number of elements that influence the ultimate level of customer charges. See pp. 34-35, below.[8]

Section 220(b) of the Act directs that the FCC "shall" prescribe depreciation for carriers subject to the Act. It also forbids such carriers from depreciating "any" property, or using "any" depreciation charges other than as prescribed by the FCC (*id.*), unless under Section 220(h), 47 U.S.C. § 220(h), the FCC excepts carriers from Section 220 and permits the states to regulate instead. Congress required the FCC to consider the "views and recommendations" of the states before adopting or altering accounting requirements including depreciation (Section 220(i), 47 U.S.C. § 220(i)) but deliberately rejected a proposed amendment to Section 220 urged by the state commissions that would have permitted them to ignore FCC depreciation and to set different depreciation for use in intrastate ratemaking. See pp. 16-18, below.

For almost 50 years, the FCC has maintained rules governing the depreciation of telephone plant. Since the 1930's, the FCC has prescribed and revised the Uniform System of Accounts for telephone companies including rules to determine the categories of plant that may be depreciated and the methods of depreciation.[9] In addition, since the late 1940's the FCC has prescribed specific depreciation rates for larger individual telephone companies subject to the Act; these prescription orders take account of variations in local conditions and are revised periodically, normally on a three-year cycle.[10]

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[8] Combining data for AT&T Communications and most of the local telephone companies, depreciation in 1984 represented about 12% of revenues. United States Telephone Association, *Statistics of the Telephone Industry* 17 (1985); AT&T Communications, *Annual Report to the FCC*, 58-60 (1984).

[9] See *Telephone Division, Order No. 7-C*, 1 F.C.C. 45 (1935). For example, under the current rules, 47 C.F.R. § 31.02-82 specifies categories of depreciable plant for larger companies and § 31.02-80 treats depreciation methods.

[10] When a telephone company does business in more than one state, the FCC may prescribe different depreciation rates for the carrier's plant located in the different states. See, *e.g.*, *In re Prescription of Revised Percentages of Depreciation*, 96 F.C.C.2d 257, 281-85 (1983), *recon. denied*, 99 F.C.C.2d 117 (1984) (prescribing different depreciation rates for Northwestern Bell property in five different states).

States have normally accepted FCC depreciation decisions without contest. See p. 21, below.

B. The FCC's 1980 and 1981 Depreciation Rules

In 1980 and 1981, the FCC revised certain of its depreciation rules.[11] Its objective was to ensure that the telephone companies be permitted to use modern depreciation methods that accurately reflect the actual rate of depreciation of telephone plant, thereby permitting timely recovery of invested capital. The need for accuracy and timely cost recovery had been greatly increased by new communications technology,[12] the growth of competition, and reduced regulation in the telephone industry.[13] More rapid technological change makes existing facilities obsolete more quickly and, unless the plant is depreciated accurately, a carrier may be left at the end of the plant's useful life with a substantial part of its investment not recovered. Competition increases the speed of technological change and limits a carrier's ability to recover undepreciated investment after the equipment has been retired.

If telephone companies cannot use accurate depreciation methods and rates to recover costs as plant is consumed, they —and the investors who supply new capital to them—are inhibited in making new investments. One consequence is that telephone customers do not get the benefit of new technology that would improve service, lower telephone rates over the long

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[11] *In re Amendment of Part 31*, 83 F.C.C.2d 267 (1980) (J.A. 4), *recon. denied*, 87 F.C.C.2d 916 (1981) (J.A. 45); *In re Amendment of Part 31*, 85 F.C.C.2d 818 (1981). References to "J.A." are to the joint appendix in this case; references to "Cal. Pet. App." are to the appendix to California's petition for certiorari in No. 84-889.

[12] Dramatic examples of new technology are the increasing use of microwave and satellite radio systems in place of landline cables and the use of electronic computer-controlled switching systems both within the network and in individual pieces of telephone equipment such as customer switchboards.

[13] Landmarks in the advent of competition are *North Carolina Utils. Comm'n* v. *FCC*, 552 F.2d 1036 (4th Cir.), *cert. denied*, 434 U.S. 874 (1977) ("*NCUC II*") (registration of customer provided telephone equipment), and *Washington Utils. & Transp. Comm'n* v. *FCC*, 513 F.2d 1142 (9th Cir.), *cert. denied*, 423 U.S. 836 (1975) (competition for specialized intercity services).

run and serve Congress' explicit goal to "make available . . . a rapid, efficient, Nation-wide . . . communication service . . . ." Section 1 of the Act. The other consequence of inadequate depreciation is that the telephone companies' books show an ever larger amount of undepreciated investment representing plant that has become obsolete and is no longer capable of producing earnings.[14] This in turn increases their borrowing costs, leading to increased customer rates, and ultimately threatens the companies' financial stability and their ability to raise capital.

In 1980 and 1981, after very extensive study including the receipt of comments from both carriers and state commissions, the FCC made three major changes to modernize depreciation:

SLELG. The FCC directed that the telephone companies subject to the Act be allowed to use the so-called "Straight Line Equal Life Group" methodology ("SLELG") in computing depreciation. The grouping of items of telephone plant is essential for computing depreciation in this industry, because there are millions of pieces of plant. SLELG is a method of grouping individual items of plant which creates smaller and more homogeneous groups than were utilized under the so-called "vintage group" method used by telephone companies in the past.[15] Based on overwhelming evidence, the FCC found that SLELG more accurately depicts actual straight line depreciation. See pp. 24-25, below.

[14] One estimate of the "reserve deficiencies" of the nation's local telephone companies is that they now total $26 billion. See Gold, *The $26 billion solution*, Forbes 40 (July 29, 1985). Without making its own computation, the National Telecommunications and Information Administration has described the reserve deficiencies as "substantial" in magnitude and "growing rapidly." NTIA, *Issues in Domestic Telecommunications: Directions for Domestic Policy* 142 (1985) ("NTIA Report"). Reserve deficiency refers to the differential between the actual consumption of telephone plant and the smaller, inadequate depreciation allowed by regulators.

[15] A brief description of SLELG and vintage group depreciation is provided in Appendix C. Under SLELG, straight line depreciation is applied to each "equal life" group. SLELG is not an "accelerated" depreciation method; rather, by more accurately computing straight line depreciation, SLELG overcomes a lag effect inherent in the vintage life method of grouping. See p. 24, below.

Remaining life. The FCC's second reform was to direct that subject carriers use a convention called "remaining life" for making mid-course corrections of past discrepancies in depreciation. It may be discovered after several years that the original rate of depreciation used for a category of plant does not match actual experience and that the plant is actually depreciating more quickly than the rate at which depreciation is being recovered through customer charges.[16] The remaining life convention approved by the FCC has a cardinal advantage over the "whole life" convention previously used by telephone companies to cope with mid-course corrections: under remaining life, the new rate of depreciation is reset after the correction to make certain that at the end of the actual useful life of the plant, the total depreciation recovered by the company will equal the net investment.[17]

Inside wiring. The third change made by the FCC was to direct that a set of plant expenditures called "inside wiring" should no longer be capitalized and depreciated by subject carriers but should be treated as an expense to be recovered in the year incurred.[18] The category of inside wiring to be expensed was one that the FCC had already found, several years earlier, was properly associated with the individual customer who placed the order.[19] The FCC found that ex-

[16] A depreciation rate, whether for an individual item of telephone plant or for a homogenous group, is normally derived by estimating the useful service life of the plant and allocating the net investment (the original cost less salvage value) evenly across the years of useful life. Especially during rapid technological change, actual experience with retirements of plant may reveal that the average life is shorter than expected so that the depreciation rate originally used is too low.

[17] A brief description of the remaining life and whole life conventions is provided in Appendix C. The main problem with whole life is that, by ignoring the inadequate depreciation already taken when the correction is made, whole life virtually assures that a carrier will have underrecovered the net investment at the end of the plant's useful life. See pp. 24-25, below.

[18] The FCC has express authority under Section 220(b) to determine *whether* a category of plant shall be depreciated, as well as to determine the depreciation rates for depreciable plant. See pp. 12-13, below.

[19] See *In re AT&T*, 64 F.C.C.2d 1, 54-56 (1977) (certain of the expenditures on material and labor costs incurred in installing inside wiring do not benefit subsequent occupants).

pensing those costs would avoid placing the burden on future customers who did not cause, and were not advantaged by, the expenditures. 85 F.C.C.2d at 828-29.

A number of the state commissions participated in the proceedings that led the FCC to reach its decisions concerning SLELG, remaining life and the expensing of inside wiring. Some objected to the use of SLELG or remaining life as increasing short-run revenue requirements for the carriers. In the expensing of inside wiring, states were divided in their views. After the FCC issued its decisions in 1980 and 1981, none of the states sought judicial review of the new depreciation rules.

C. The FCC's Preemption Decision and Judicial Review

During the FCC proceedings that led to the 1980 and 1981 rule changes, it had been taken for granted that the states would continue to respect the FCC's depreciation decisions, as they normally had done in the past. Nevertheless, following the FCC's new rules, NARUC [20] and the California Commission asked the FCC in April 1981 to rule that the states were free to ignore FCC depreciation requirements.

On April 27, 1982, the FCC issued a decision on the NARUC-California request. *In re Amendment of Part 31,* 89 F.C.C.2d 1094 (Cal. Pet. App. A-26). By a four-to-three vote, the FCC declined to read Section 220 as automatically compelling the states to follow FCC depreciation decisions. The FCC reaffirmed its own authority to preempt inconsistent state action that would interfere with FCC policy;[21] but it found no immediate need to exercise that authority, because, as it later explained, it expected state commissions to continue their ordinary practice of following FCC depreciation rulings. *In re Amendment of Part 31,* 92 F.C.C.2d 864, 866-67 (1983) (Cal. Pet. App. A-58-59).

[20] NARUC, the National Association of Regulatory Commissioners, regularly litigates on behalf of the state commissions and represents their interests in congressional hearings.

[21] "Section 2(b) does not prohibit [FCC] preemption of state regulatory actions that might interfere with or tend to frustrate policies or rules we have adopted to carry out statutory objectives with respect to interstate and foreign communications." 89 F.C.C.2d at 1108 (Cal. Pet. App. A-48).

AT&T and GTE promptly asked the FCC to reconsider its decision.[22] On January 6, 1983, the FCC released its Preemption Order, unanimously ruling that its depreciation decisions did preempt conflicting state regulation. It rested its Preemption Order on two independent grounds:

First. Based on reexamination of Section 220(b) and its legislative history, the FCC concluded that FCC decisions on depreciation for subject carriers automatically bind the state commissions. It found that this reading was confirmed by Section 220(h) which permits the FCC to substitute state regulation and by Section 220(i) which invites states to provide their "views and recommendations" to the FCC. Further, the FCC found that Section 220 reenacted a provision that had given the ICC preemptive authority over depreciation rates and that Congress specifically had refused to alter the existing preemptive language to give the states a right to set their own depreciation rates.

Second. Apart from automatic statutory preemption, the FCC found that preemption was necessary to avoid frustration of federal policy.[23] The FCC found that depreciation is a significant cost that must be recovered in both interstate and intrastate rates, and that state rules that understate depreciation harm the network: such harms include inadequate capital recovery by carriers, injury to the carriers' ability and incentive to modernize their plant, and ultimately loss of new facilities and improved service for the public.

The FCC's Preemption Order was limited solely to requiring respect for its depreciation decisions; it did not preempt the

[22] J.A. 66; J.A. 122. AT&T's petition for reconsideration urged the agency to reexamine the question of automatic preemption under Section 220(b) in light of legislative evidence on which the FCC had not focused. A General Telephone subsidiary, providing telephone service in Ohio, filed a petition for a declaratory ruling showing that the Ohio Commission had already forbidden the use of SLELG and remaining life and urging the FCC to preempt in order to avoid widespread frustration of its policy. J.A. 89.

[23] Contrary to its initial expectation in 1982, the FCC found that a number of states had already declined to follow its new depreciation rules. Thirteen states had refused to accept SLELG and 9 states had rejected remaining life. 92 F.C.C.2d at 877 n.14 (Cal. Pet. App. A-76).

states in determining the ultimate rates to be charged to customers for intrastate services. 92 F.C.C.2d at 879-80 (Cal. Pet. App. A-79-80). Nevertheless, a number of state commissions joined in seeking judicial review of the Preemption Order in the Fourth Circuit.[24] In June 1984, the Fourth Circuit sustained the FCC's Preemption Order on the ground that the FCC had authority to preempt state regulation that conflicted with federal agency rules and thwarted federal policy for the network.[25]

The FCC's Preemption Order has now been in effect for almost three years and has been respected by most state commissions. Where state agencies have sought to disregard the order, district courts have normally enforced the FCC's depreciation requirements in injunction actions.[26] The phase-in process for SLELG and remaining life is now essentially complete, and the FCC's new prescriptions of depreciation for subject carriers normally reflect SLELG and remaining life depreciation.

SUMMARY OF ARGUMENT

1. The FCC correctly construed Section 220 of the Act to make FCC depreciation decisions for carriers subject to the Act binding on the state commissions. Congress directed the FCC to prescribe depreciation (Section 220(b)), prohibited carriers from using "any" depreciation other than that prescribed by the FCC (*id.*) unless the FCC affirmatively delegated authority to the states (Section 220(h)), and took account of state interests

[24] Under the Hobbs Act, the Fourth Circuit thereby acquired "exclusive jurisdiction" to review the decision. 28 U.S.C. § 2342. See *FCC* v. *ITT World Communications, Inc.*, 104 S. Ct. 1936 (1984).

[25] *Virginia State Corporation Commission* v. *FCC*, 737 F.2d 388 (Cal. Pet. App. A-1). One judge, who had earlier dissented in both *NCUC I* and *NCUC II*, dissented from both the panel decision and the denial of rehearing *en banc*. In none of the Fourth Circuit cases has any other judge agreed with the petitioners' position.

[26] This Court has agreed to review one such decision to address procedural issues under Section 401. *Public Service Commission of Maryland* v. *C&P Telephone Co., cert. pending*, No. 84-1362.

by requiring the FCC to consider the "views and recommendations" of state commissions (Section 220(i)). Section 220 reenacted a provision of the Interstate Commerce Act that had already been construed by the ICC as giving it preemptive power to determine depreciation for both railroad and telephone plant. In reenacting this provision in the Communications Act, Congress considered and specifically rejected an amendment urged by the state commissions which would have empowered them to set different depreciation rates for intrastate rate proceedings.

2. Independent of statutory preemption, preemption by federal agency action occurs where, as here, the agency reasonably determines to preempt in order to prevent the frustration of federal policy. *Capital Cities Cable, Inc.* v. *Crisp*, 104 S. Ct. 2694 (1984) ("*Crisp*"). The FCC found in this case that new federal depreciation rules which ensure accurate depreciation were needed to achieve timely capital recovery and to provide incentives vital to modernizing the nation's telephone network. Because the same plant is used in common for both interstate and intrastate communications, the investment must be recovered through both interstate and intrastate rates; and inadequate state-ordered depreciation would frustrate the federal objectives by impairing timely capital recovery and inhibiting new investment in the network. In addition, inconsistent state depreciation conflicts with the FCC's own new depreciation rules, and state regulation in conflict with lawful federal rules is therefore preempted. See *Free* v. *Bland*, 369 U.S. 663 (1962).

3. Preemption of inconsistent state regulation of depreciation is not barred by Section 2(b)(1) of the Act which reserves to the states authority over intrastate customer charges and related subjects. Congress specifically gave the FCC overriding authority over depreciation for subject carriers in Section 220 and "specific terms prevail over the general" in statutory construction. *Fourco Glass Co.* v. *Transmirra Products Corp.*, 353 U.S. 222, 228 (1957). Moreover, the language and legislative history of Section 2(b)(1) show that it was directed to preventing the FCC from setting individual customer charges for intrastate services, which the FCC has not done in this case.

Finally, the FCC's holding that Section 2(b)(1) is inapplicable rests on a consistent line of decisions in the courts of appeals which this Court has repeatedly declined to review.

ARGUMENT

I. THE FCC REASONABLY CONSTRUED SECTION 220 OF THE ACT TO REQUIRE THE USE OF FCC PRESCRIBED DEPRECIATION IN STATE PROCEEDINGS FOR CARRIERS SUBJECT TO THE ACT.

Under well established doctrine, state regulation is foreclosed when Congress itself has made a *statutory* determination to override state regulation, by expressly so providing, by implication, by occupying the field, or by any other means that makes Congress' intent clear.[27] Here, Section 220 of the Act requires that the FCC's depreciation decisions preempt state regulation. The FCC's interpretation of the statute accords with both the language and legislative history of Section 220, and is entitled to special weight because the expert agency has diligently reexamined the complex statute it is assigned to administer and has unanimously settled on a reasoned interpretation.[28]

A. The Language and Structure of Section 220 Show That FCC Depreciation Decisions Bind the States.

Congress' intent is, first and foremost, to be sought in its statutory language.[29] Section 220(b) says that the FCC "shall"

[27] See, *e.g.*, *Shaw* v. *Delta Air Lines, Inc.*, 463 U.S. 85, 95 (1983) (preemption "is compelled whether Congress' command is explicitly stated in the statute's language or implicitly contained in its structure and purpose"), quoting *Fidelity Fed. Sav. & Loan Ass'n* v. *de la Cuesta*, 458 U.S. 141, 152-53 (1982), and *Jones* v. *Rath Packing Co.*, 430 U.S. 519, 525 (1977).

[28] *Chemical Mfrs. Ass'n* v. *NRDC*, 105 S. Ct. 1102, 1108 (1985) (agency interpretation due "considerable deference"); *Red Lion Broadcasting Co.* v. *FCC*, 395 U.S. 367, 381 (1969) (same); *NLRB* v. *Local Union No. 103*, 434 U.S. 335, 351 (1978) (new agency interpretation adopted on reexamination of statute entitled to weight).

[29] *E.g.*, *Park 'N Fly, Inc.* v. *Dollar Park and Fly, Inc.*, 105 S. Ct. 658, 662 (1985); *Kosak* v. *United States*, 104 S. Ct. 1519, 1523 (1984); *INS* v. *Phinpathya*, 104 S. Ct. 584, 589 (1984).

prescribe classes of carrier depreciable property and the percentage of depreciation to be charged for each class.[30] Section 220 applies by its terms to *all* carriers subject to the Act.[31] Section 220 is not qualified by language limiting its application only to interstate communication; by contrast, other provisions of the Act, requiring that tariffs be filed with the FCC and that rates be reasonable, apply only to "interstate and foreign communication." Sections 201, 203, 47 U.S.C. §§ 201, 203.

Section 220(b) bears out Congress' intent that carriers be governed by one regime for depreciation by directing that subject carriers "shall not" charge depreciation for "any" class of property or utilize "any" depreciation percentages other than as prescribed by the FCC.[32] Other provisions of Section 220 forbid such carriers from keeping any accounts, records and memoranda other than those prescribed or approved by the FCC unless the FCC authorizes additional, state-requested data.[33] If Congress had intended that different depreciation accounts be kept by carriers for state ratemaking purposes, it would not have included this blanket prohibition.

The role of the states in depreciation is directly addressed in Section 220(i). That subsection provides that the FCC, before exercising its authority under Section 220, "shall notify" the state commissions and provide an opportunity to the states to "present [their] views" and shall "consider such views and

[30] The first sentence of Section 220(b) reads in full: "The Commission shall, as soon as practicable, prescribe for [carriers subject to the Act] the classes of property for which depreciation charges may be properly included under operating expenses, and the percentages of depreciation which shall be charged with respect to each of such classes of property, classifying the carriers as it may deem proper for this purpose."

[31] Section 2(a) of the Act makes it applicable not only to interstate communication but also to anyone who engages in such communication.

[32] The third sentence of Section 220(b) provides: "[Carriers subject to the Act] shall not, after the Commission has prescribed the classes of property for which depreciation charges may be included, charge to operating expenses any depreciation charges on classes of property other than those prescribed by the Commission, or, after the Commission has prescribed percentages of depreciation, charge with respect to any class of property a percentage of depreciation other than that prescribed therefor by the Commission."

[33] See Sections 220(d) and (g), 47 U.S.C. §§ 220(d), (g). See also p. 22, n.57, below.

recommendations." Congress gave the states an opportunity to present their views because it expected them to be bound by the resulting prescriptions.[34] Section 220(h) permits the FCC to "except" carriers from its decisions under Section 220 and permits separate state regulation only when the FCC expressly finds that such action would be "consistent with the public interest." [35] Unless the FCC affirmatively exercises its discretion under Section 220(h) to waive or delegate its authority, the states cannot adopt inconsistent regulations.

Taken together, the provisions of Section 220 that apply to depreciation form a coherent whole. Congress clearly intended that there be one regime—rather than multiple regimes—of depreciation for each subject carrier. The FCC was given responsibility for establishing such a regime, and its depreciation decisions have to be respected unless and until it relinquishes authority to the states in individual instances. The states' interest is recognized but their role is confined to providing their "views and recommendations." [36]

Congress' decision to give the FCC overriding authority over depreciation conforms to the approach used elsewhere in the Act in like circumstances. In particular, the FCC alone makes the final decision in separations proceedings to allocate common investment between the interstate rate base and the intrastate rate base under Section 221(c) and 410(c) of the Act;[37] this final authority exercised by the FCC directly affects the regulation of both interstate and intrastate communication.

[34] The very fact that the FCC is required to notify the states and consider their views or recommendations is because states will be bound by the outcome. See *Shields* v. *Utah I.C. R.R.*, 305 U.S. 177, 182 (1938).

[35] Section 220(h) reads in pertinent part: "The Commission . . . may, if it deems such action consistent with the public interest, except the carriers of any particular class or classes in any State from any of the requirements under this section in cases where such carriers are subject to State commission regulation with respect to matters to which this section relates."

[36] Where Congress has wanted to authorize a state to use depreciation rates inconsistent with those fixed by the federal agency, it has said so explicitly. *E.g.*, Natural Gas Act, § 9(a), 15 U.S.C. § 717h(a).

[37] Section 410(c); H.R. Rep. No. 429, 92nd Cong., 1st Sess. 3 (1971) ("the State board members would not vote on the final decisions"). See *Illinois Bell Tel. Co.* v. *Illinois Commerce Comm'n*, 740 F.2d 566, 567 (7th Cir. 1984) (FCC has "final authority" over separations).

Once again, state interests are safeguarded by permitting the states to vote on a "recommended decision" on separations prepared by a joint federal-state board. *Id.*

In each case, Congress saw that the subject matter required one agency—the FCC—to have the last word. Obviously, when investment in common plant is "separated" between the interstate and intrastate rate bases, someone must make the final decision on the formula to be used, so that the separated portions will add up to 100 percent. Similarly, it is not surprising that Congress recognized that an individual piece of commonly used telephone plant located in one place depreciates at a single rate, and empowered the FCC to determine that rate.[38]

B. The Legislative History of Section 220 Confirms That Congress Intended to Preempt Inconsistent State Depreciation and Rejected a Proposal to Allow States to Set Different Depreciation Rates.

The legislative history of Section 220 confirms Congress' specific intent that, once the FCC has prescribed depreciation for subject carriers, inconsistent state regulation must give way. Until passage of the Communications Act in 1934, telephone companies were regulated by the Interstate Commerce Commission (see 36 Stat. 544-45), and the Interstate Commerce Act was the model for the new Communications Act.[39] Section 220's core provisions reenact, almost verbatim, Section 20(5) and related provisions of the Interstate Commerce Act. Section 20(5) (set forth at p. 5b, below) was enacted in 1920 (41 Stat. 493-94) to require the ICC to prescribe depreciation for both telephone companies and railroads.

[38] Due to local conditions (*e.g.*, weather, volume of usage), items of plant may deteriorate more quickly in one part of the country than in another; but the FCC's depreciation prescriptions do provide different depreciation rates in those circumstances. See p. 4, above.

[39] Interpretations of the Interstate Commerce Act therefore have been given great weight in interpreting the Communications Act. See, *e.g.*, *ABC* v. *FCC*, 643 F.2d 818, 820-21 (D.C. Cir. 1980); *AT&T* v. *FCC*, 449 F.2d 439 (2d Cir. 1971).

When the Communications Act was being framed, Section 20(5) of the Interstate Commerce Act had already been construed as preempting state depreciation if and when the ICC exercised its power to prescribe depreciation.[40] This reading of Section 20(5) as preempting state authority was no secret to Congress; the state commissions had been urging the repeal or amendment of Section 20(5) throughout the 1920's,[41] and they opposed its reenactment as part of the new Communications Act precisely because of its preemptive effect. In hearings in 1930 on an early version of the new Act, NARUC and various state commissions argued that reenactment of Section 20(5) in the Communications Act would destroy state regulatory power, warning that reenactment would enable the new FCC to take over "all matters of depreciation . . . without regard to the action upon the same subject by the State Commission." [42]

By 1934, the state commissions had persuaded the drafters to add a new Section 220(j) to the revised bills introduced for consideration that year. This new Section 220(j)—which was not enacted—would explicitly have permitted the states to prescribe their own depreciation requirements for purposes of

[40] See *Depreciation Charges of Telephone Companies* and *Depreciation Charges of Steam Railroad Companies*, decided together at 118 I.C.C. 295, 330 (1926), *further proceedings*, 177 I.C.C. 351 (1931). NARUC did not contest the ICC's power to preempt but urged it not to do so as a matter of discretion; the ICC rejected the request. 118 I.C.C. at 330. See also *Accounting Rules for Telephone Companies*, 203 I.C.C. 13, 17 (1934).

[41] Resolutions to this end were passed at NARUC conventions repeatedly. See *Hearings on S.2910 Before the Senate Comm. on Interstate and Foreign Commerce*, 73rd Cong., 2d Sess. 184 (1934) (statement of NARUC representative).

[42] *Hearings on S. 6 Before the Senate Comm. on Interstate Commerce*, 71st Cong., 2d Sess. 2243 (1930) (resolution of Montana Commission); *id.* at 2213-17 (statement of NARUC representative). S. 6, 71st Cong., 1st Sess. § 37(b) (1930), was derived from Section 20(5) and is practically identical to the present Section 220(b).

determining intrastate rates.[43] This provision was introduced at the direct request of the state commissions[44] and was contained in the version of the bill reported by the House Committee and passed by the House itself. Significantly, the House report acknowledged that its version of Section 220(j) would have altered existing law, stating:

> "[The provision is] responsive to the requests of the State commissions that *the present law be changed* so as to permit those bodies to exercise, for State purposes, certain jurisdiction over accounting systems and methods of depreciation accounting." H.R. Rep. No. 1850, 73rd Cong., 2d Sess. 7 (1934) (emphasis added).[45]

However, while the states were seeking to prevent reenactment of Section 20(5), both the ICC and the telephone companies were strongly opposed to the proposed NARUC modification, especially in the Senate. The ICC spokesman testified that the NARUC proposal "directly conflicts with, and destroys the uniformity of systems of accounts and depreciation accounting required by the preceding provisions of the section. That is not true under the present law." [46] As a result, the

[43] Section 220(j), as initially proposed in H.R. 8301, 73rd Cong., 2d Sess. § 220(j) (1934), and S. 2910, 73rd Cong., 2d Sess. § 220(j) (1934), provided that nothing in Section 220 would

> "limit the power of a State commission to prescribe, for the purposes of the exercise of its jurisdiction with respect to any carrier, the percentage rate of depreciation to be charged to any class of property of such carrier, or the composite depreciation rate, for the purpose of determining charges, accounts, records, or practices . . . ."

[44] See *Hearings on S. 2910, supra*, at 179 (statement of Senator Dill); *id.* at 184 (statement of NARUC representative).

[45] A similar explanation of the proposed Section 220(j), as "a change necessary" to permit the state commissions to prescribe depreciation, was given by the Chairman of the House Committee in a House debate (78 Cong. Rec. 10,314 (1934) (Rep. Rayburn)) and by the NARUC spokesman. See, *e.g.*, *Hearings on S. 2910, supra*, at 181 (statement of NARUC representative).

[46] *Hearings on S. 2910, supra*, at 208 (1934). A similar, very extensive attack on the notion of dual systems of depreciation as a prelude to "chaos" was made by AT&T's president and echoed by the spokesman for the association representing independent telephone companies. *Id.* at 95-96 (statement of AT&T president); *id.* at 139-40 (statement of USITA president).

Senate Committee reported, and the Senate adopted, a quite different version of Section 220(j) which (unlike the House-passed bill) did not reserve *any* authority to the state commissions; it merely directed the FCC to investigate and report on the need for legislation to grant authority to the states in the future.[47]

When the conflicting versions of Section 220(j) reached the Conference Committee, that committee framed the final language of Section 220 contained in the enacted version. The Conference Committee included in the final statute the present Section 220(h), which the House had enacted to permit the FCC to delegate authority over depreciation or other accounting to the state commissions *if* the FCC chose to do so. However, in Section 220(j), the Conference Committee adopted a more general version of the Senate provision, which retained existing federal authority and called for an investigation into the need for further legislation.[48]

The result can be briefly summarized. Congress enacted in Section 220 depreciation provisions that it knew had been construed by the responsible agency to give that agency preemptive authority over depreciation. Standing alone, that reenactment would itself be strong evidence of Congress' intent

[47] See S. 3285, 73rd Cong., 2d Sess. § 220(j) (1934), reported as a substitute for S. 2910. As the Senate report explained, its version of Section 220 retained existing federal authority over accounting and depreciation for the time being. S. Rep. No. 781, 73rd Cong., 2d Sess. 5 (1934). NARUC testified that the House bill was "all right" and the revised Senate bill was "all wrong" on the issue of state authority over depreciation. *Hearings on H.R. 8301 Before the Senate Comm. on Interstate and Foreign Commerce*, 73rd Cong., 2d Sess. 137 (1934). NARUC's representative admitted that the Senate's revision of Section 220(j) had responded to AT&T's criticisms. *Id.* at 140.

[48] See H.R. Rep. No. 1918, 73rd Cong., 2d Sess. 47 (1934) (Conference Report). Section 220(j) as passed by Congress is essentially a condensed version of Section 220(j) as passed by the Senate. "The obvious inference to be drawn is that the conferees were not prepared at that time to allow the states to prescribe depreciation rates different than those established at the federal level, but the matter might be considered later if the report required by Section 220(j) indicated it to be appropriate." 92 F.C.C.2d at 873 (Cal. Pet. App. A-69).

to preserve existing authority.[49] Even more telling, Congress considered and then explicitly refused to enact the NARUC sponsored provision—the House version of Section 220(j)—that would have given the states authority to set different depreciation rates for intrastate proceedings.[50] The states are now seeking from this Court the very power that Congress deliberately refused to grant them in 1934.

C. The FCC's Reading of Section 220 Is Consistent Both With Its Regulatory Purpose and With Prior Practice Under the Act.

Faced with the preemptive language of Section 220(b) and its legislative history, the Louisiana brief filed by three of the petitioners [51] claims that the FCC's depreciation and accounting prescriptions under Section 220 are simply irrelevant in determining the costs to be used in establishing a carrier's revenue requirements. In substance, Louisiana argues that the FCC's actions under Section 220 involve merely "a system of notation" for record-keeping purposes and have no substantive import. La. Br. 27; *id.* at 5-8, 26-28, 37-38. Resting on a jumble of out-of-context quotations and misdescriptions, the claim is flatly wrong and would reduce Section 220 to "a feeble gesture." 92 F.C.C.2d at 870 (Cal. Pet. App. A-64).

The cardinal importance of depreciation to utilities is *precisely* its impact upon the carrier's revenue requirement. Depreciation affects both the carrier's net investment on which

[49] *E.g., Lindahl* v. *OPM*, 105 S. Ct. 1620, 1629 n.15 (1985); *Lorillard* v. *Pons*, 434 U.S. 575, 580-81 (1978).

[50] This refusal is strong evidence of Congress' intent. *E.g., Baldridge* v. *Shapiro*, 455 U.S. 345, 357-58 (1982); *FEC* v. *Democratic Senatorial Campaign Comm.*, 454 U.S. 27, 35-36 (1981).

[51] One petitioner brief has been joined by Louisiana, Ohio and Florida ("La. Br."); the other petitioner brief, joined by California, NARUC, and a number of state commissions ("Calif. Br."), places its main stress on a jurisdictional argument considered in part III below.

it is allowed to earn a return and the level of expenses that it may recover.[52] This central role of depreciation in the economic regulation of carriers explains why Congress made it mandatory for the FCC to regulate depreciation in Section 220 and why the FCC has expended so much time and energy in establishing depreciation rules and prescribing depreciation rates for individual major carriers. It also explains why NARUC in the 1920's urged the ICC not to prescribe depreciation[53] and why NARUC fought so vigorously in the 1930's, without success, to prevent the enactment of Section 220 in its current form. See pp. 16-17, above.

The scraps of quotation offered by Louisiana, in support of its "notation" argument, dissolve on examination. In general, they concern accounting matters other than depreciation and merely make clear that the entry of an item into a particular account does not resolve every ratemaking question that can arise.[54] The few cited cases that do relate to depreciation confirm that depreciation directly affects a carrier's revenue requirement; and none of the cited cases involving depreciation adopted Louisiana's "notation" argument. See p. 21, below. It is not surprising that Louisiana's argument was scarcely presented in the briefs filed in the court below.

[52] Thus, an increase in depreciation (1) increases the immediate depreciation expense (and lessens the amount of depreciation remaining to be taken) and (2) reduces the net investment on which a return is earned. See P. Garfield & W. Lovejoy, *Public Utility Economics* 95-96 (1964). Accordingly, the increase in depreciation means that customers ultimately pay fewer dollars: the total depreciation expense over the life of the investment remains the same (original investment less salvage value) but the total return on investment is less, because the net investment declines more rapidly.

[53] NARUC argued that if depreciation "is to be fixed by the Federal Government" and applied to "local properties of telephone companies where used to some extent in interstate toll service . . . [then much] of the total revenue which the State commissions must provide in establishing rates will be for purposes entirely removed from any jurisdiction of those commissions." See *Depreciation Charges, supra,* 118 I.C.C. at 330.

[54] This, in substance, is what the FCC represented to this Court in *AT&T* v. *United States,* 299 U.S. 232 (1936), when it said that accounting would "not necessarily" determine ultimate treatment in ratemaking. For example, an expense may be properly classified under the FCC's system of accounts but may be disallowed as an expense (*e.g.,* because it is excessive or unnecessary).

The Louisiana brief also asserts that the FCC's reading of the Act is inconsistent with "50 years of history." La. Br. 2-3. It would be wrong to expect perfect uniformity over a half century, but actual practice supports the FCC's position. The FCC established rules for depreciation as early as 1935 and, by the end of the 1940's, it was prescribing depreciation rates for larger telephone companies. See p. 4, above. While the FCC has regularly consulted with the state commission staffs and received information from them, the FCC itself has prescribed the depreciation rates. Once the FCC has prescribed depreciation, the states normally have followed FCC depreciation decisions.[55]

Louisiana's brief, ranging over 50 years of history, has found exactly *one* reported case approving an actual state deviation in the determination of depreciation. That case, which petitioners repeatedly cite as an "*e.g.*" without any other example, is a California decision which *approved* remaining life even before the FCC had done so.[56] The decision deserves no weight because, in discussing state authority over depreciation, it did not even address Section 220 of the Act.[57]

Even if the FCC had read the Act differently over many years and even if past practice were flatly inconsistent with its

[55] *Virginia State Corporation Commission* v. *FCC, supra,* 737 F.2d at 394 (Cal. Pet. App. A-13-14); *In re Amendment of Part 31, supra,* 89 F.C.C.2d at 1106 (Cal. Pet. App. A-45). Louisiana gains no support from state regulation that *preceded* depreciation decisions by the FCC. As this Court held in construing Section 20(5), the states were permitted to prescribe depreciation "*until* the Interstate Commerce Commission could act administratively to prescribe rates." *Northwestern Bell Tel. Co.* v. *Nebraska State Ry. Comm'n,* 297 U.S. 471, 478-79 (1936) (emphasis added). See also *Smith* v. *Illinois Bell Tel. Co.,* 282 U.S. 133, 159-60 (1930).

[56] *Pacific Tel. & Tel. Co.* v. *Public Utils. Comm'n,* 401 P.2d 353 (Cal 1965). *Southern Bell Tel. & Tel. Co.,* 66 P.U.R.3d 1 (Fla. 1966), proclaimed state authority but actually followed the FCC's depreciation prescriptions.

[57] Most of Louisiana's examples involve state creation of sub-accounts or related matters. From the outset, the FCC has given blanket approval allowing telephone companies to maintain sub-accounts requested by state commissions so long as the state requirements do not frustrate the basic FCC accounting regime. See *Telephone Division, Order No. 7-C,* 1 F.C.C. 45 (1935); 47 C.F.R. §§ 31.01-2(d)(1), (f).

present position, the FCC could adopt a new reading and alter past practice when justified by new circumstances.[58] No such justification is required in this case. Before the present controversy, the states generally did follow FCC depreciation decisions. Requiring continued state respect for FCC depreciation decisions will maintain the actual *status quo ante*—state respect for FCC depreciation decisions—as it has existed for over a half century.

II. THE FCC LAWFULLY PREEMPTED INCONSISTENT STATE REGULATION OF DEPRECIATION WHICH FRUSTRATED FEDERAL POLICY AND CONFLICTED WITH FEDERAL RULES.

Although Congress itself may preempt state authority either explicitly or by implication, statutory preemption is *not* the only basis on which state authority may be superseded. As this Court recently explained, "federal regulations have no less pre-emptive effect than federal statutes" and "a preemptive regulation's force does not depend on express congressional authorization to displace state law." [59] Independent of statutory preemption under Section 220(b), the FCC lawfully invoked agency preemption in this case to preempt state regulation. Such agency preemption was justified both to avoid the frustration of federal policy and because inconsistent state regulation conflicts with federal depreciation rules.

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[58] *E.g., American Trucking Ass'ns* v. *Atchison, T.&S.F.Ry.*, 387 U.S. 397, 416 (1967) ("the Commission, faced with new developments or in light of reconsideration of the relevant facts and its mandate, may alter its past interpretation and overturn past administrative rulings and practice"); *Permian Basin Area Rate Cases*, 390 U.S. 747, 784 (1968).

[59] *Fidelity Fed. Sav. & Loan Ass'n* v. *de la Cuesta, supra*, 458 U.S. at 153-54 (emphasis added). Compare decisions of this Court refusing to preempt *because* the federal agency declined to do so. *E.g., Arkansas Elec. Coop. Corp.* v. *Arkansas Pub. Serv. Comm'n*, 461 U.S. 375 (1983); *Hillsborough County* v. *Automated Medical Laboratories, Inc.*, 105 S.Ct. 2371 (1985).

A. The FCC Reasonably Found That Inconsistent State Regulation of Depreciation for Subject Carriers Would Frustrate Federal Policy.

Less than two years ago, this Court in the *Crisp* case [60] expressly affirmed the FCC's power to preempt state regulation to avoid frustration of federal policy, stating:

> "[I]f the FCC has resolved to pre-empt an area of . . . regulation and if this determination 'represents a *reasonable accommodation* of conflicting policies' that are within the agency's domain, . . . we must conclude that all conflicting state regulations have been precluded." 104 S. Ct. at 2701 (emphasis added and footnote omitted).

A uniform line of decisions upholding FCC preemption exists in the courts of appeals, including cases in the First Circuit,[61] Second Circuit,[62] Fourth Circuit,[63] and District of Columbia Circuit.[64] This preemptive power has been crucial in implementing the FCC's major policy reforms, including connection of customer-provided telephone sets to the network, competition in intercity communication, and provision of telephone equipment and computer related services on a competitive basis.[65]

In this case, the FCC's intent is clear (92 F.C.C.2d at 879 (Cal. Pet. App. A-79)) and it rests on an explicit, ultimate finding that "it is essential to preempt inconsistent state depreciation practices to avoid frustration of . . . vital national policies" discussed in its decision. *Id.* at 878 (Cal. Pet. App. A-

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[60] *Capital Cities Cable, Inc.* v. *Crisp, supra*, 104 S. Ct. 2694.

[61] *Puerto Rico Tel. Co.* v. *FCC*, 533 F.2d 694 (1st Cir. 1977).

[62] *New York Tel. Co.* v. *FCC*, 631 F.2d 1059 (2d Cir. 1980); *Brookhaven Cable TV, Inc.* v. *Kelly*, 573 F.2d 765 (2d Cir. 1978), *cert. denied*, 441 U.S. 904 (1979).

[63] *NCUC I, supra*, 537 F.2d 787; *NCUC II, supra*, 552 F.2d 1036.

[64] *Computer and Comm'ns Indus. Ass'n* v. *FCC*, 693 F.2d 198 (D.C. Cir. 1982), *cert. denied*, 461 U.S. 938 (1983) ("*Computer II*"); *People of the State of California* v. *FCC*, 567 F.2d 84 (D.C. Cir. 1977), *cert. denied*, 434 U.S. 1010 (1978).

[65] See *NCUC II, supra*, 552 F.2d 1036; *New York Tel. Co.* v. *FCC, supra*, 631 F.2d 1059; *Computer II, supra*, 693 F.2d 198.

78). Under the "reasonable accommodation" standard of *Crisp*, the governing inquiry is whether the FCC had a rational basis for this ultimate finding. A rational basis exists because, as the FCC amply demonstrated, inconsistent state depreciation would frustrate federal objectives to which the FCC's 1980 and 1981 reforms had been directed.

As the FCC explained in adopting its 1980 and 1981 depreciation rules, accurate depreciation plays several critical roles in this capital intensive industry. It permits effective rate of return regulation by regulators, properly depicts a carrier's financial health for investors, and assures the timely recovery of invested capital to provide the carrier's management with the incentive and wherewithal for new investment. 83 F.C.C.2d at 271-75 (J.A. 8-15). These functions depend on the use of depreciation methods and rates that accurately measure the consumption of capital. *Id.* at 271-72 (J.A. 8-10).

The enormous reserve deficiency that now exists in the telephone industry shows that prior depreciation has not kept pace with actual capital consumption. One reason is that vintage group depreciation and whole life have a built-in tendency to defer depreciation so that it lags behind actual consumption. See pp. 6, 7, above. Deferred depreciation is increasingly dangerous in a period of rapid technological change and increasing competition. 83 F.C.C.2d at 281, 287, 290 (J.A. 23-24, 31-32, 35-36).[66] The overwhelming evidence before the FCC showed, and the FCC so found, that the use of SLELG and remaining life does produce more accurate capital recovery based on better measurements of actual straight line

[66] As already noted, competition has a double effect on depreciation: it stimulates technological innovation, shortening the useful service life of existing and newly installed plant; and it increases the risk that if investment is not fully recovered over the life of the plant, competition will prevent telephone rates from being maintained to recoup the undepreciated investment.

depreciation than the prior methods. 83 F.C.C.2d at 281 (J.A. 23).[67] Given the FCC's expertise, its technical findings on this issue would have to be sustained even if they were open to review.[68]

The FCC was not concerned with abstract perfection for its own sake but with an urgent practical problem of assuring timely capital recovery to create the means and incentive for new investment in the telephone network. Capital recovery that matches the actual rate of depreciation, the result that SLELG and remaining life helped to achieve, stimulates new investment both by increasing cash flow and by reducing the risk that new investment will not be fully recovered.[69] See pp. 26, 27 n. 74, below. Moreover, it is this new investment that is primarily responsible for *reducing* the ultimate rates charged to telephone customers over the long run and permitting them to enjoy the benefits of a "communication service with adequate facilities at reasonable charges." Section 1 of the Act.[70]

Here, the FCC rationally found that the state commissions' refusal to follow the new and more accurate depreciation methods would frustrate FCC policy and impair the network. 92 F.C.C.2d at 875-78 (Cal. Pet. App. A-73-78). As the FCC

[67] The FCC's finding of greater accuracy was supported by expert evidence from major accounting firms, Coopers & Lybrand and Arthur Andersen, by the American Institute of Certified Public Accountants, and by a lengthy study by Ernst & Ernst. *Id.* at 278-80 (J.A. 20-23).

[68] NARUC and the state commissions participating in the FCC proceedings never sought direct review of the 1980 and 1981 depreciation rules, and the time for doing so has long since expired. 28 U.S.C. § 2344.

[69] Conversely, "[a]rtificially retarded depreciation hurts investment ability in two ways: it raises the cost of capital by contributing to perceptions of these firms as poor risks, and it diminishes their ability to fund investment internally, since depreciation provides a source of internal cash." NTIA Report 140-41.

[70] Long-distance telephone rates fell steadily after World War II largely because new investment in advanced long-distance transmission systems, capable of handling much larger volumes of traffic at even lower cost per unit, were installed throughout the network. Similarly, both local and long-distance rates have been held down primarily because the telephone companies have substituted automatic switching systems for operators at switchboards; and this evolution is now entering a new phase as electronic switching systems are substituted for electro-mechanical ones.

explained, the vast bulk of telephone plant in the United States is "used interchangeably to provide interstate and intrastate communications." *Id.* at 877 (Cal. Pet. App. A-75-76). Much of the investment in both existing and new telephone plant is assigned by the FCC, in its separations rules, to be recovered through intrastate rates. Depreciation is the means by which that investment is recovered.

If the interstate rates include depreciation computed through accurate depreciation methods but the intrastate rates do not, a substantial portion of the investment in common plant would be recovered too slowly or not at all. 92 F.C.C.2d at 876-77 (Cal. Pet. App. A-75-76). New investment would be discouraged to the detriment of the entire network. *Id.* Put differently, a telephone company pays for 100 percent, not 25 percent, of a new cable or system; if the new cable or switch is not acquired when needed because a state refuses to allow adequate depreciation of the portion of the plant assigned to intrastate service, then it is interstate as well as intrastate service that suffers.[71]

In sum, the FCC rationally found that the use of inconsistent depreciation methods by the states would frustrate the very reforms the FCC sought to implement in 1980 and 1981. Similarly, NTIA, after a thorough study, recently confirmed the threat of "frustration of [federal telecommunications] policies should states successfully resist FCC or court mandates on depreciation recovery for future investment." NTIA Report 139. The FCC's appraisal is ample basis for its decision to preempt. The question, as this Court emphasized in *Crisp*, is not whether the FCC's judgment enjoys "universal support." 104 S. Ct. at 2705. Instead, it is whether the federal agency has "acted arbitrarily," and the reviewing court's inquiry is a "limited" one.[72]

[71] The FCC also relied upon other benefits of a uniform depreciation regime. In particular, it found that such a regime would reduce difficulties encountered when assets commonly used in interstate and intrastate service are converted from regulated to unregulated service (92 F.C.C.2d at 876-77 (Cal. Pet. App. A-75-76)) and that such a regime helps ensure proper separation of commonly used property between the interstate and intrastate rate bases. *Id.* at 878 (Cal. Pet. App. A-77-78).

[72] *Fidelity Fed. Sav. & Loan Ass'n* v. *de la Cuesta, supra*, 458 U.S. at 154. See also *United States* v. *Shimer*, 367 U.S. 374. 381-82 (1961).

The California brief—but not the Louisiana brief—makes a frontal attack on the reasonableness of the FCC's decision to preempt. California asserts that state constitutions and statutes already require state regulators to allow "timely capital recovery." Calif. Br. 35-36. This bland assurance ignores the fact that capital recovery that is merely "timely" enough to avoid confiscation and meet state statutory standards is not invariably the same as recovery that will keep the telephone network in step with the challenges and opportunities of rapidly changing technology and consumer needs.[73] "Most state regulators perceive political pressure to keep local telephone rates as low as possible" (NTIA Report 139) even though "[i]n the longer term, faulty depreciation policy will raise rates and diminish service quality to all users." *Id.* at 140. Moreover, the FCC did not preempt in this case until it first found that a significant number of states were refusing to follow the FCC methods. See p. 9 n.23, above.

California further argues that preemption will not spur plant replacement because it has only an indirect effect on new investment. Calif. Br. 36. However, as the FCC found, timely depreciation does spur new investment (83 F.C.C.2d at 281 (J.A. 23-24)), and the relationship between faster depreciation and increased investment has been recognized for years.[74] California also complains that the FCC has not required that new funds generated by timely depreciation be committed to plant replacement. Calif. Br. 36. However, the carriers' past track record shows that they will continue to modernize without compulsion if capital is available and the risk of unduly delayed cost recovery is overcome.

[73] In this very case, the objections that NARUC and a number of state commissions made to the FCC in opposing SLELG did not rest on any doubts about its accuracy but merely on the states' desire not to increase short-run revenue requirements. See 83 F.C.C.2d at 278 (J.A. 20).

[74] Timely depreciation increases cash flow to permit new investment with reduced outside borrowing, reduces the risk for management in making new investment, and may even reduce the cost of borrowing outside capital if faster recovery reduces investor risk. See 1 A. Kahn, *The Economics of Regulation: Principles and Institutions* 117-22 (1970); P. Garfield & W. Lovejoy, *supra*, at 109-11.

Finally, California claims that faster and more accurate depreciation would frustrate the FCC's own desire to promote competition by telephone companies because higher prices for services will decrease the carriers' ability to market their services. Calif. Br. 37. On the contrary, carrier investments are often made precisely because new facilities will permit service at *lower* cost over the life of the plant in question and this fact is borne out by the history of modernized telephone plant and lower telephone rates for the last 50 years. See p. 27, above.[75] FCC depreciation does not require increased rates for particular competitive services but merely ensures that overall carrier revenue requirements allow for actual depreciation.[76]

B. Inconsistent State Regulation Conflicts With the FCC's Depreciation Rules.

State regulation is preempted not only where it frustrates federal agency policy but also where there is a conflict between a specific federal-agency rule and an inconsistent state action. It has been settled for years that a valid federal regulation preempts conflicting state law, and "[t]he relative importance to the State of its own law is not material . . . for the Framers of our Constitution provided that the federal law must prevail." [77]

In 1980 and 1981, the FCC established new rules to govern depreciation of telephone plant commonly used for interstate and intrastate service. See pp. 6-8, above. The FCC has express authority under Section 2(a) over "all interstate . . . communication by wire or radio" which includes all telephone

[75] Indeed, the competitors of regulated carriers do generally use faster depreciation rates. NTIA Report 135-41.

[76] Because telephone plant is commonly used for a number of different services, the states in designing or approving the design of charges for individual intrastate services can help ensure that the telephone companies' competitive position is not improperly impaired. 92 F.C.C.2d at 874 (Cal. Pet. App. A-70-71).

[77] *Free* v. *Bland, supra,* 369 U.S. at 666 (Treasury regulation creating right of survivorship in U.S. Savings Bonds preempts inconsistent Texas community property law).

[78] Sections 3(a) and (b), 47 U.S.C. §§ 153(a), (b), include in the definition of communication all "instrumentalities, facilities [and] apparatus . . . incidental to" transmission.

plant incidental to such transmission.[78] This telephone plant, even where it lies solely within one state, is subject to the FCC's depreciation authority so long as it is used or usable for interstate communication.[79]

The FCC exercised its authority by adopting rules approving the use of SLELG and remaining life depreciation for carriers subject to the Act and determining that such carriers are entitled to utilize those methods. See pp. 6-8, above. The FCC has also now held that its rules are intended to apply to determining depreciation of such telephone plant, whether the subject carriers are participating in an FCC or a state agency proceeding. 92 F.C.C.2d at 879-80 (Cal. Pet. App. A-78-79). The FCC's reading of its own rules could scarcely be disputed especially where, as here, it has shown *why* that reading is necessary to give effect to the underlying purpose of the rules. See pp. 23-28, above.[80]

State commissions are acting in direct contravention of the FCC's new depreciation rules where they preclude carriers from using SLELG or remaining life in state proceedings. It is irrelevant whether the FCC has made use of SLELG and remaining life mandatory or merely elective for the carrier.[81] Where the FCC's rules intend that a carrier be given an option, a state's attempt to deprive the carrier of such an option is no less a conflict with the FCC's determination.[82]

[79] *E.g., United States* v. *Southwestern Cable Co.,* 392 U.S. 157 (1968); *Ward* v. *Northern Ohio Tel. Co.,* 300 F.2d 816 (6th Cir.), *cert. denied,* 371 U.S. 820 (1962).

[80] *E.g., Ford Motor Credit Co.* v. *Milhollin,* 444 U.S. 555, 566 (1980) ("[a]n agency's construction of its own regulations has been regarded as especially due that respect"); *Udall* v. *Tallman,* 380 U.S. 1, 16-17 (1965).

[81] The FCC has made the use of SLELG elective for the carriers, rather than mandatory, because some telephone companies do not yet have the capability to implement SLELG. 83 F.C.C.2d at 284-85 (J.A. 27-30).

[82] The FCC's telephone equipment registration rules, sustained in *NCUC II,* permit rather than require customers to connect their own telephones to the network, but it is settled that these rules preempt any state interference with this option to connect. See *NCUC I,* 537 F.2d at 790, 793-94. Similarly, when the FCC preempted states and local entry regulation of satellite master antenna television, it did not compel anyone to provide that service but merely prevented the states from depriving potential providers of their option to offer the service. *New York State Comm'n on Cable Television* v. *FCC,* 749 F.2d 804, 805-06 (D.C. Cir. 1984).

Although the FCC was concerned with the overall threat to its policies, it did confront a specific instance of state conflict with FCC depreciation rules in this case. General Telephone Company of Ohio sought to compute its depreciation in proceedings before the Ohio Commission using the same SLELG and remaining life computations that were approved by the FCC's depreciation rules. Even though the resulting depreciation rates had actually been prescribed by the FCC, the Ohio Commission refused to recognize the FCC's rules and orders as controlling. The conflict between the FCC's rules and inconsistent state action was therefore not an abstract possibility, but an actual event, and that conflict was specifically addressed by the FCC in this case and formed part of the basis of its determination. See 92 F.C.C.2d at 865, 879-80 (Cal. Pet. App. A-55, 79-80).

A state ban on SLELG or remaining life forbids the carriers to do precisely what the FCC rules permit. Such state action, like the Oklahoma advertising ban struck down in *Crisp*, "plainly conflicts with specific federal regulations." 104 S.Ct. at 2703. Thus, the preemption of state regulation is required not only to avoid frustration of the purpose underlying the FCC's rules but also to avoid conflict with the rules themselves. This conflict provides a further basis for agency preemption in this case.

III. SECTION 2(b)(1) DOES NOT BAR EITHER STATUTORY OR AGENCY PREEMPTION IN THIS CASE.

Both the Louisiana and California briefs place substantial weight on Section 2(b)(1) of the Communications Act.[83] California reads this section as qualifying whatever preemptive effect might otherwise flow from Section 220 itself. Calif. Br. 14-16. Both California and Louisiana argue that Section 2(b)(1) restricts the FCC's own authority to preempt. *E.g.*, La. Br. 22. The states' interpretation of Section 2(b)(1) is at

[83] That section provides that subject to the radio licensing provisions, the Act does not apply or give the FCC authority over "charges, classifications, practices, services, facilities, or regulations for or in connection with intrastate communication service by wire or radio of any carrier." 47 U.S.C. § 152(b)(1).

odds with its language, its legislative history and a uniform line of authority interpreting it.[84]

A. The Specific Treatment of Depreciation in Section 220 Governs in This Case.

The language and legislative history of Section 220 of the Act show that Congress had a clear intent that the FCC determine depreciation methods of subject carriers and that, when the FCC has done so, state agencies are not entitled to require different depreciation rates for the same telephone plant. See pp. 12-19, above. In fact, Congress in 1934 directly considered whether Section 220 should be amended to give the states a right to adopt such separate depreciation rates and refused to grant such authority. *Id.* In short, Section 220 specifically resolves the preemption question in favor of federal authority and does so based on specific congressional intent.

However Section 2(b)(1) might be read in other situations, there is no way that it can be read to override the specific congressional determination to preempt state authority over depreciation. As this Court said in *Fourco Glass Co.* v. *Transmirra Products Corp., supra,* 353 U.S. at 228-29:

> "[T]he law is settled that 'However inclusive may be the general language of a statute, it "will not be held to apply to a matter specifically dealt with in another part of the same enactment. . . . Specific terms prevail over the general in the same or another statute which might otherwise be controlling." *Ginsberg & Sons* v. *Popkin,* 285 U.S. 204, 208.' "

This principle has been repeatedly followed by this Court and by lower courts and directly applies in this case.[85]

[84] The state commissions also refer in passing to Section 221(b) of the Act, 47 U.S.C. § 221(b), but its legislative history shows that this provision was directed to the narrow problem, not involved in this case, of local exchanges overlapping state lines. See, *e.g.*, *Computer II, supra,* 693 F.2d at 216-17 & nn. 103, 104, citing legislative history and the decisions of three other circuits.

[85] See *MacEvoy Co.* v. *United States,* 322 U.S. 102, 107 (1944); *Ginsberg & Sons, Inc.* v. *Popkin,* 285 U.S. 204, 208 (1932); *AT&T* v. *FCC,* 487 F.2d 865 (2d Cir. 1973).

To read Section 2(b)(1)'s general language to override Section 220's specific treatment of depreciation would also conflict with the internal evidence in Section 220 itself. As the states interpret Section 2(b)(1), carriers subject to the Act would be forced, contrary to the express language of Section 220(b), to "charge . . . a percentage of depreciation other than that prescribed therefor by the [FCC]." 47 U.S.C. § 220(b). Carriers would be "except[ed]" from requirements of Section 220 by state rather than FCC action. Compare Section 220(h). And the states would no longer be confined to providing their "views and recommendations" to the FCC on proposed depreciation changes, in accordance with Section 220(i), but would be able to dictate depreciation for much of the telephone plant in the United States.

The states' reading also defies the specific congressional purpose. In 1920, Congress adopted the predecessor of Section 220(b), requiring the ICC to fix depreciation rates, in order to "put[ ] an end to the existing system under which there are as many different systems of depreciation as there are carriers." [86] In the Communications Act of 1934, Congress reenacted the language of the Interstate Commerce Act reflecting this requirement, and after debate expressly rejected "the requests of the State Commissions that the present law be changed" so that they could adopt their own "methods of depreciation accounting." [87] It is inconceivable that Congress intended to frustrate these specific decisions as to depreciation by general language in Section 2(b)(1).

B. The States' Reading of Section 2(b)(1) Is Inconsistent With Its Language and Its Legislative History.

The defining phrase in Section 2(b)(1)—including the references to charges, classifications, practices and regulations—closely parallels similar defining language used repeat-

[86] H.R. Rep. No. 456, 66th Cong., 1st Sess. 31 (1919), explaining language adopted in Section 20(5) of the Interstate Commerce Act and now contained in Section 220(b) of the Communications Act. See p. 15, above.

[87] H.R. Rep. No. 1850, 73rd Cong., 2d Sess. 7 (1934), explaining proposed Section 220(j), which Congress refused to enact.

edly in Sections 201-05 of the Act, 47 U.S.C. §§ 201-05.[88] Sections 201-05 directly govern the carriers' rate and service relationships with their customers and not their depreciation or accounting. The term "charges" is repeatedly used in Sections 201-05 to refer to customer charges, and the "classifications," "practices" and "regulations" referred to are those that delineate the customer charges for services provided to customers.[89] Similarly, the cases under Sections 201-05 treat the classifications, regulations and practices there described as those bearing upon customer charges.[90]

Reading the language of Section 2(b)(1) *in pari materia* with the same language in Sections 201-05, it becomes clear that Congress was concerned in Section 2(b)(1) with *customer* charges and not *depreciation* charges. Similarly, the practices, classifications and regulations referred to in Section 2(b)(1) are those that delineate customer charges for intrastate services; Congress was not attempting to preserve state authority over practices, classifications or regulations for depreciation and accounting, a subject which it had entrusted the FCC to regulate under Section 220. This basic distinction is a complete answer to the states' linguistic argument.

This reading of Section 2(b)(1) is confirmed by its legislative history. The origin of the pertinent subparagraph (1)—reserving state authority over "intrastate communication"—is undisputed. The provision was proposed by the state commissions in reaction to the Court's earlier decision in

[88] Section 201(b), 47 U.S.C. § 201(b), requires that "charges, practices, classifications, and regulations" for interstate service be "just and reasonable." Section 202(a), 47 U.S.C. § 202(a), forbids unreasonable discriminations or preferences in "charges, practices, classifications, regulations, facilities, or services." Sections 203-05, 47 U.S.C. §§ 203-05, contain similar language.

[89] Section 201(a), for example, refers to the "charges" for through routes and the "divisions of such charges," referring to the amounts charged by carriers to customers and the need to divide the revenues between the carriers where a joint through charge is made. Similarly, Section 203(a) requires carriers to publish tariffs showing "all charges" between points served on its system or connecting carriers and showing "the classifications, practices and regulations affecting such charges."

[90] *E.g., AT&T* v. *FCC*, 572 F.2d 17 (2d Cir.), *cert. denied*, 439 U.S. 875 (1978); *AT&T* v. *FCC*, *supra*, 449 F.2d 439.

the *Shreveport Rate Case*, holding that the ICC had power to order an increase in specific intrastate railroad rates charged to customers where necessary to eliminate discrimination against interstate commerce.[91] In other words, Section 2(b)(1) was from the outset concerned with protection against federal preemption of the states' setting of individual customer charges for specific intrastate services.[92]

This restriction is *not* violated by the FCC's Preemption Order. Depreciation comprises only about 10-15 percent of revenue requirements, and it does not determine the ultimate charges at either the interstate or intrastate level. The level of rates to be charged for individual intrastate services is fixed only after the aggregate "revenue requirement" for all intrastate services has been determined, and depreciation is only one of a number of elements that affect each carrier's revenue requirement.[93] Once the revenue requirement is determined, the state commission then approves or permits specific rates for individual intrastate services to be fixed so that the total expected revenue from those rates will match the carrier's total intrastate revenue requirement.[94]

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[91] *Houston, E. & W. Texas Ry.* v. *United States*, 234 U.S. 342 (1914) ("*Shreveport Rate Case*"). The hostility of the state commissions to *Shreveport*, and their design of Section 2(b), is undisputed. *E.g., Hearings on S. 2910, supra*, at 155 (statement of NARUC representative).

[92] State commissions properly had far more reason to be concerned about *Shreveport* and the federal determination of intrastate rates than about depreciation. The ICC, which continued to retain its *Shreveport* powers over intrastate railroad rates, used this authority for many years to order general adjustments in intrastate railroad rates.

[93] The intrastate revenue requirement equals return on net investment attributable to intrastate service (computed by using the rate of return allowed on such investment by the state commission) plus the predicted ongoing expenses of the carrier in providing intrastate service including operating expenses, depreciation and taxes.

[94] This phase, often called rate design, involves a range of choices because there are various mixes of rates for different services that can add up to the same revenue requirement. Ultimately, the rate for each service, multiplied by the expected volume of service at that rate, produces an estimated total revenue for the service; and the final mix is set so that the sum of these revenues for all of the services matches the revenue requirement.

Thus, the FCC by determining depreciation affects only one element in this complicated equation, and the FCC does not determine the ultimate intrastate customer charge for *any* intrastate service when it determines depreciation under Section 220(b) any more than when it separates investment between federal and state rate bases pursuant to Section 221(c). Nor is there any automatic relationship between a change in depreciation and a change in the rate ultimately charged to customers for any individual intrastate service. This basic point was expressly conceded by the states in the court below. As the Virginia Commission stated:

> "The [FCC] preemption order affects neither the myriad of other factors affecting the total revenue requirement, which must be derived from the aggregate of individual prices, *or the prices for individual services* (rate design)." [95]

Section 2(b) cannot be extended beyond its established purpose as revealed in the legislative history. At most, Congress intended in the disputed language of Section 2(b) to negate *Shreveport* and to prevent the FCC from fixing the rates charged to customers for individual intrastate services. Congress did not mean, as the states now contend, that the FCC is precluded from determining issues merely because those determinations *affect* intrastate rates. The FCC affects intrastate rates every day in the exercise of its express powers under the Act.[96] To read Section 2(b)(1) to bar such effects is not merely implausible but impossible.

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[95] Brief of the Virginia Commission, p. 37 (emphasis added) in the Fourth Circuit in this case, joined by other state commissions including California, Florida and Ohio.

[96] Separations rules (47 C.F.R. § 67.1, *et seq.*) adopted by the FCC under Sections 221(c) and 410(c) govern many more accounts than depreciation alone and ultimately affect intrastate rates far more pervasively than do FCC depreciation rules. Similarly, FCC rules permitting connection of customer provided equipment to the network (47 C.F.R. § 68.1, *et seq.*) and detariffing carrier provided telephone sets and similar equipment (47 C.F.R. § 64.702) affect both carrier revenues and carrier costs at the intrastate level.

C. A Uniform Line of Court of Appeals Decisions Squarely Rejects the States' Interpretation.

There is an additional reason, persuasive to four courts of appeals, why Section 2(b)(1) cannot apply in this case. Sections 1 and 2(a) of the Act give the FCC overriding authority over interstate communication; and, with qualifications, Section 2(b)(1) reserves to the state commissions authority over certain aspects of intrastate communication. From the outset, the appellate courts have recognized that the bare language of these provisions does not resolve cases where there is an *overlap* of interstate and intrastate concerns.[97] Resolving such "overlap" issues in favor of federal supremacy, the courts of appeals have repeatedly interpreted Section 2(b)(1) as confined to intrastate matters which are "separable from and do not substantially affect" interstate communication.[98]

This reading of Section 2(b)(1), three times reaffirmed by the Fourth Circuit, has also been adopted by the First Circuit, the Second Circuit, and the District of Columbia Circuit in numerous decisions.[99] This Court denied certiorari in a number of these same cases. No court of appeals has reached an inconsistent conclusion or read Section 2(b)(1) in the fashion urged by petitioners. This uniform judicial interpretation, reading the Act to affirm federal supremacy on common issues,

[97] See, *e.g.*, *NCUC I*, *supra*, 537 F.2d at 792, where Judge Hastie observed that juxtaposing the language of these sections "creates the . . . dispute but, considered alone, does not resolve it."

[98] See *Computer II*, *supra*, 693 F.2d at 215, quoting *NCUC I*, *supra*, 537 F.2d at 793. *NCUC I* held: "section 2(b) deprive[s] the [FCC] of regulatory power over local services, facilities and disputes that in their nature and effect are separable from and do not substantially affect the conduct or development of interstate communications." *Id.*

[99] First Circuit: *Puerto Rico Tel. Co.* v. *FCC*, *supra*, 553 F.2d 694. Second Circuit: *New York Tel. Co.* v. *FCC*, *supra*, 631 F.2d 1059; *Brookhaven Cable TV, Inc.* v. *Kelly*, *supra*, 573 F.2d 765. Fourth Circuit: *NCUC I*, *supra*, 537 F.2d 787; *NCUC II*, *supra*, 557 F.2d 1036; *Virginia State Corp. Comm'n* v. *FCC*, *supra*, 737 F.2d 388 (Cal. Pet. App. A-1); *Fort Mill Tel. Co.* v. *FCC*, 719 F.2d 89 (4th Cir. 1983). D.C. Circuit: *Computer II*, *supra*, 693 F.2d 198; *People of the State of California* v. *FCC*, *supra*, 567 F.2d 84; *NARUC* v. *FCC*, 737 F.2d 1095 (D.C. Cir. 1984), *cert. denied*, 105 S. Ct. 1224 (1985).

is the foundation for many of the FCC's major regulatory initiatives that are now part of the structure of the telecommunications industry. See, *e.g.*, p. 36, n. 99, above.

This Court has not definitively construed Section 2(b)(1), but the courts of appeals' interpretation is consistent with, and strongly supported by, this Court's decisions in the related area of cable television. In those cases, this Court has generally upheld FCC regulation of cable television, where found necessary by the agency, *despite* the effect on local activities or displacement of local regulation.[100] Cable television systems are local facilities, they have no physical connection to an interstate network, and the Act's specific provisions do not give the FCC any express authority over cable television. The present case involves the physically integrated, federally regulated interstate telephone network. The FCC's exercise of preemptive power over matters of common concern affecting the telephone network should be sustained even more readily than its authority over cable television already upheld by this Court.

If this Court confirms the reading of Section 2(b)(1) uniformly adopted in the lower federal courts, that ends the petitioners' objection. *NCUC I* said that Section 2(b) applies only to local matters that are "separable from and do not substantially affect" interstate communication. 537 F.2d at 793. Because the same telephone plant is used interchangeably for interstate as well as intrastate communication, as was true in *NCUC I* and is true in this case, the facilities are clearly not "separable from" interstate communication; and the determination of depreciation rates for such plant, whether applied in FCC or state proceedings, does "substantially affect" the con-

[100] See, *e.g.*, *United States* v. *Southwestern Cable Co.*, *supra*, 392 U.S. 157; *Capital Cities Cable, Inc.* v. *Crisp*, *supra*, 104 S. Ct. 2694. *Southwestern Cable*, the leading case in this line, was directly relied upon by a number of courts of appeals decisions construing Section 2(b)(1). *E.g.*, *People of the State of California* v. *FCC*, *supra*, 567 F.2d at 86; *New York Tel. Co.* v. *FCC*, *supra*, 631 F.2d at 1066.

duct and development of interstate communications. The FCC so found in this case,[101] and the states' attack upon the findings is without merit. See pp. 24-26, above.

Over 15 years ago, the Chief Justice, then sitting as a judge on a court of appeals, considered the relation of Sections 2(a) and 2(b) in an opinion sustaining FCC regulation of cable television. After reviewing this Court's precedents, the Chief Justice held that the Act has given the FCC adequate power to fulfill its "comprehensive and pervasive" responsibilities.[102] He continued:

> "Any other determination would tend to fragment the regulation of a communications activity which cannot be regulated on any realistic basis except by a central authority; fifty states and myriad local authorities cannot effectively deal with bits and pieces of what is really a unified system of communication." *Id.*

What was true of cable television in 1969 is vastly more true today of the telephone network itself. On certain regulatory issues, there must be "a central authority," and only the FCC can perform that role. *Id.* Otherwise, coherent regulation is impossible and the nation's "unified system of communication" will not achieve the goals established by Congress in Section 1 of the Act. *Id.*[103]

[101] "Here the setting of depreciation rates is not an essentially local incident or practice and it has substantial effects upon the administration and development of the interstate telephone network." 92 F.C.C.2d at 875 (Cal. Pet. App. A-72).

[102] *General Tel. Co.* v. *FCC, supra,* 413 F.2d at 401 (Burger, J.).

[103] This interpretation of the Act does not preclude a meaningful role for the states in regulating telecommunications. Recent events have left the state agencies with a full agenda, including problems of intrastate rate design, local deregulation, and intrastate competition (see NTIA Report 104-29), and the FCC has increased its efforts to consult. *E.g., MTS and WATS Market Structure,* 50 Fed. Reg. 939 (1985) (adopting joint board recommendations on access charges). It does mean that on issues of common concern where a single voice is essential, the FCC's decision must prevail.

CONCLUSION

For the reasons stated, the Fourth Circuit's decision upholding the FCC Preemption Order should be affirmed.[104]

Respectfully submitted,

DONALD McG. ROSE*
DAVID C. HORN
2500 Central Trust Center
201 East Fifth Street
Cincinnati, OH 45202
(513) 651-6944
Attorneys for Cincinnati Bell Telephone Company

JOHN WOHLSTETTER*
1800 K Street, N.W.
Washington, D.C. 20006
(202) 466-2895
Attorney for Continental Telecom, Inc.

CAROLYN C. HILL*
1875 Eye Street, N.W.
Washington, D.C. 20006
(202) 659-4600

RONALD T. LEMAY
5454 West 110th Street
P.O. Box 7927
Overland Park, KS 66207
(913) 345-6057
Attorneys for United Telephone System, Inc.

MICHAEL BOUDIN*
CHRISTOPHER T. CURTIS
ELIZABETH V. FOOTE
1201 Pennsylvania Ave., N.W.
P.O. Box 7566
Washington, D.C. 20044
(202) 662-6000
Attorneys for AT&T and the former Bell System Operating Companies (other than Cincinnati Bell Telephone Company, Nevada Bell, and Pacific Bell)

FRANCINE J. BERRY
W. PRESTON GRANBERY
295 North Maple Avenue
Basking Ridge, NJ 07920
(202) 221-3327
Attorneys for AT&T

ALBERT H. KRAMER*
2000 M Street, N.W.
Washington, D.C. 20036
(202) 223-6611
Attorney for North American Telecommunications Association

[104] The appeal of the Louisiana Commission should be dismissed for want of jurisdiction. *Silkwood* v. *Kerr-McGee Corp.,* 104 S. Ct. 615, 620-21 (1984).

THOMAS J. REIMAN
30 South Wacker Drive
Chicago, IL 60606
(312) 750-5255

ALFRED WINCHELL WHITTAKER
655-15th Street, N.W.
Washington, D.C. 20005
(202) 879-5090
Attorneys for the Ameritech Telephone Companies

LAURENCE W. DEMUTH, JR.
7800 E. Orchard Road
Englewood, CO 80111
(303) 793-6310

DAVID S. SATHER
ROBERT MCKENNA
1020-19th Street, N.W.
Washington, D.C. 20036
(202) 429-0303
Attorneys for Mountain States Telephone and Telegraph Company, Northwestern Bell Telephone Company and Pacific Northwest Bell Telephone Company

SAUL FISHER
500 Westchester Avenue
White Plains, NY 10604
(914) 683-2266

JOHN B. MESSENGER
1828 L Street, N.W.
Washington, D.C. 20036
(202) 955-1170
Attorneys for the NYNEX Telephone Companies

MARK J. MATHIS
D. MICHAEL STROUD
1710 H Street, N.W.
Washington, D.C. 20006
(202) 392-5111
Attorneys for the Bell Atlantic Telephone Companies

VINCENT L. SGROSSO
675 West Peachtree St., N.E.
Atlanta, GA 30375
(404) 529-8231
Attorney for the BellSouth Telephone Companies

EDGAR MAYFIELD
1010 Pine Street
St. Louis, MO 63101
(314) 247-4995
Attorney for Southwestern Bell Telephone Company

WILLIAM O'KEEFE
227 Church Street
New Haven, CT 06503
(203) 771-8818
Attorney for the Southern New England Telephone Company

November 1985

* *Counsel of Record*

APPENDIX A[1]

SUBSCRIBING PARTIES

American Telephone and Telegraph Company
The Bell Telephone Company of Pennsylvania
The Chesapeake and Potomac Telephone Company
The Chesapeake and Potomac Telephone Company of Maryland
The Chesapeake and Potomac Telephone Company of Virginia
The Chesapeake and Potomac Telephone Company of West Virginia
Cincinnati Bell Telephone Company
Continental Telecom, Inc.
The Diamond State Telephone Company
Illinois Bell Telephone Company
Indiana Bell Telephone Company
Michigan Bell Telephone Company
The Mountain States Telephone and Telegraph Company
New England Telephone and Telegraph Company
New Jersey Bell Telephone Company
New York Telephone Company
North American Telecommunications Association [2]
Northwestern Bell Telephone Company
The Ohio Bell Telephone Company
Pacific Northwest Bell Telephone Company
South Central Bell Telephone Company
Southern Bell Telephone and Telegraph Company
The Southern New England Telephone Company
Southwestern Bell Telephone Company
United Telephone System, Inc.
Wiconsin Bell Inc.

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[1] The listing required by S. Ct. R. 28.1 is contained in the joint motion to dismiss and opposition to certiorari filed by the subscribing parties in these cases. In addition to the companies there listed, FiberLan, Inc. should now be included as a partly-owned subsidiary of BellSouth Corporation.

[2] Formerly North American Telephone Association.

APPENDIX B

RELEVANT STATUTORY PROVISIONS

Section 2 of the Communications Act of 1934, ch. 652, 48 Stat. 1064 (codified as amended at 47 U.S.C. § 152)

"(a) The provisions of this chapter shall apply to all interstate and foreign communication by wire or radio and all interstate and foreign transmission of energy by radio, which originates and/or is received within the United States, and to all persons engaged within the United States in such communication or such transmission of energy by radio, and to the licensing and regulating of all radio stations as hereinafter provided; but it shall not apply to persons engaged in wire or radio communication or transmission in the Canal Zone, or to wire or radio communication or transmission wholly within the Canal Zone. The provisions of this chapter shall apply with respect to cable service, to all persons engaged within the United States in providing such service, and to the facilities of cable operators which relate to such service, as provided in subchapter V-A of this chapter.

(b) Except as provided in section 224 of this title and subject to the provision of section 301 of this title and subchapter V-A of this chapter, nothing in this chapter shall be construed to apply or to give the Commission jurisdiction with respect to (1) charges, classifications, practices, services, facilities, or regulations for or in connection with intrastate communication service by wire or radio of any carrier, or (2) any carrier engaged in interstate or foreign communication solely through physical connection with the facilities of another carrier not directly or indirectly controlling or controlled by, or under direct or indirect common control with such carrier, or (3) any carrier engaged in interstate or foreign communication solely through connection by radio, or by wire and radio, with facilities, located in an adjoining State or in Canada or Mexico (where they adjoin the State in which the carrier is doing

business), of another carrier not directly or indirectly controlling or controlled by, or under direct or indirect common control with such carrier, or (4) any carrier to which clause (2) or clause (3) of this subsection would be applicable except for furnishing interstate mobile radio communication service or radio communication service to mobile stations on land vehicles in Canada or Mexico; except that sections 201 to 205 of this title shall, except as otherwise provided therein, apply to carriers described in clauses (2), (3), and (4) of this subsection."

Section 220 of the Communications Act of 1934, ch. 652, 48 Stat. 1064, 1078 (codified as amended at 47 U.S.C. § 220)

"(a) The Commission may, in its discretion, prescribe the forms of any and all accounts, records, and memoranda to be kept by carriers subject to this chapter, including the accounts, records, and memoranda of the movement of traffic, as well as of the receipts and expenditures of moneys.

(b) The Commission shall, as soon as practicable, prescribe for such carriers the classes of property for which depreciation charges may be properly included under operating expenses, and the percentages of depreciation which shall be charged with respect to each of such classes of property, classifying the carriers as it may deem proper for this purpose. The Commission may, when it deems necessary, modify the classes and percentages so prescribed. Such carriers shall not, after the Commission has prescribed the clasess [sic] of property for which depreciation charges may be included, charge to operating expenses any depreciation charges on classes of property other than those prescribed by the Commission, or, after the Commission has prescribed percentages of depreciation, charge with respect to any class of property a percentage of depreciation other than that prescribed therefor by the Commission. No such carrier shall in any case include in any form under its operating or other expenses any depreciation or other charge or expenditure included elsewhere as a depreciation charge or otherwise under its operating or other expenses.

(c) The Commission shall at all times have access to and the right of inspection and examination of all accounts, records, and memoranda, including all documents, papers, and correspondence now or hereafter existing, and kept or required to be kept by such carriers, and the provisions of this section respecting the preservation and destruction of books, papers, and documents shall apply thereto. The burden of proof to justify every accounting entry questioned by the Commission shall be on the person making, authorizing, or requiring such entry and the Commission may suspend a charge or credit pending submission of proof by such person. Any provision of law prohibiting the disclosure of the contents of messages or communications shall not be deemed to prohibit the disclosure of any matter in accordance with the provisions of this section.

(d) In case of failure or refusal on the part of any such carrier to keep such accounts, records, and memoranda on the books and in the manner prescribed by the Commission, or to submit such accounts, records, memoranda, documents, papers, and correspondence as are kept to the inspection of the Commission or any of its authorized agents, such carrier shall forfeit to the United States the sum of $500 for each day of the continuance of each such offense.

(e) Any person who shall willfully make any false entry in the accounts of any book of accounts or in any record or memoranda kept by any such carrier, or who shall willfully destroy, mutilate, alter, or by any other means or device falsify any such account, record, or memoranda, or who shall willfully neglect or fail to make full, true, and correct entries in such accounts, records, or memoranda of all facts and transactions appertaining to the business of the carrier, shall be deemed guilty of a misdemeanor, and shall be subject, upon conviction, to a fine of not less than $1,000 nor more than $5,000 or imprisonment for a term of not less than one year nor more than three years, or both such fine and imprisonment: *Provided*, That the Commission may in its discretion issue orders specifying such operating, accounting, or financial papers, records, books, blanks, or documents which may, after a reasonable time, be destroyed, and prescribing the length of time such books, papers, or documents shall be preserved.

(f) No member, officer, or employee of the Commission shall divulge any fact or information which may come to his knowledge during the course of examination of books or other accounts, as hereinbefore provided, except insofar as he may be directed by the Commission or by a court.

(g) After the Commission has prescribed the forms and manner of keeping of accounts, records, and memoranda to be kept by any person as herein provided, it shall be unlawful for such person to keep any other accounts, records, or memoranda than those so prescribed or such as may be approved by the Commission or to keep the accounts in any other manner than that prescribed or approved by the Commission. Notice of alterations by the Commission in the required manner or form of keeping accounts shall be given to such persons by the Commission at least six months before the same are to take effect.

(h) The Commission may classify carriers subject to this chapter and prescribe different requirements under this section for different classes of carriers, and may, if it deems such action consistent with the public interest, except the carriers of any particular class or classes in any State from any of the requirements under this section in cases where such carriers are subject to State commission regulation with respect to matters to which this section relates.

(i) The Commission, before prescribing any requirements as to accounts, records, or memoranda, shall notify each State commission having jurisdiction with respect to any carrier involved, and shall give reasonable opportunity to each such commission to present its views, and shall receive and consider such views and recommendations.

(j) The Commission shall investigate and report to Congress as to the need for legislation to define further or harmonize the powers of the Commission and of State commissions with respect to matters to which this section relates."

Section 20(5) of the Interstate Commerce Act, added by the Transportation Act of 1920, ch. 91, 435, 41 Stat. 456, 493-94 (codified at 49 U.S.C. § 1144)

"(5) The Commission may, in its discretion, prescribe the forms of any and all accounts, records, and memoranda to be kept by carriers subject to the provisions of this Act, including the accounts, records, and memoranda of the movement of traffic, as well as of the receipts and expenditures of moneys. The Commission shall, as soon as practicable, prescribe, for carriers subject to this Act, the classes of property for which depreciation charges may properly be included under operating expenses, and the percentages of depreciation which shall be charged with respect to each of such classes of property, classifying the carriers as it may deem proper for this purpose. The Commission may, when it deems necessary, modify the classes and percentages so prescribed. The carriers subject to this Act shall not charge to operating expenses any depreciation charges on classes of property other than those prescribed by the Commission, or charge with respect to any class of property a percentage of depreciation other than that prescribed therefor by the Commission. No such carrier shall in any case include in any form under its operating or other expenses any depreciation or other charge or expenditure included elsewhere as a depreciation charge or otherwise under its operating or other expenses. The commission shall at all times have access to all accounts, records, and memoranda, including all documents, papers, and correspondence now or hereafter existing, and kept or required to be kept by carriers subject to this Act, and the provisions of this section respecting the preservation and destruction of books, papers, and documents shall apply thereto, and it shall be unlawful for such carriers to keep any other accounts, records, or memoranda than those prescribed or approved by the Commission, and it may employ special agents or examiners, who shall have authority under the order of the Commission to inspect and examine any and all accounts, records, and memoranda, including all documents, papers, and correspondence now or hereafter existing and kept or required

to be kept by such carriers. This provision shall apply to receivers of carriers and operating trustees. The provisions of this section shall also apply to all accounts, records, and memoranda, including all documents, papers, and correspondence now or hereafter existing, kept during the period of Federal control, and placed by the President in the custody of carriers subject to this Act."

H.R. 8301, 73rd Cong., 2d Sess. § 220(j) (1934)

"(j) Nothing in this section shall (1) limit the power of a State commission to prescribe, for the purposes of the exercise of its jurisdiction with respect to any carrier, the percentage rate of depreciation to be charged to any class or property of such carrier, or the composite depreciation rate, for the purpose of determining charges, accounts, records, or practices, or (2) relieve any carrier from keeping any accounts, records, or memoranda which may be required to be kept by any State commission in pursuance of authority granted under State law."

APPENDIX C

DESCRIPTION OF SLELG AND REMAINING LIFE

The Straight Line Equal Life Group Method

Assume that a group of six telephone poles installed at the same time have predicted service lives, based on past experience, such that out of any such group of six, two can be expected to be retired from service at the end of three years, two more at the end of four years, and the remaining two at the end of the fifth year. Under the vintage group method, all six poles would be treated as a group because their "vintage" or year of installation is the same.

Treated as a group, they have an "average" estimated life of four years, because total number of estimated years of use for the group is 24 years (2 x 3 years plus 2 x 4 years plus 2 x 5 years) and the number of poles is six (24 ÷ 6 = 4). A four year life yields an average rate of depreciation for the group of 25 percent a year.[1] If the poles cost $60 apiece, and have no salvage value after retirement, then the net investment would be $360. Under the vintage group method, the telephone company would determine its yearly depreciation expense by multiplying the 25 percent depreciation rate times the cost of the poles remaining in service during the year. The resulting yearly depreciation expense for the group is as shown in the following table:

	Year					Total
	1	2	3	4	5	
Three year poles	$30	$30	$30	—	—	$ 90
Four year poles	30	30	30	30	—	120
Five year poles	30	30	30	30	30	150
Total:	$90	$90	$90	$60	$30	$360

[1] This 25 percent depreciation rate would produce an annual depreciation expense of $15 for each pole in service ($60 x 25 percent).

The total depreciation expense is $360, the total cost of the six poles. However, the depreciation expense for the three year poles is only $90, $30 less than their cost. That shortfall is made up by an equal overdepreciation of the five year poles. Thus, the vintage group method defers full recognition of the depreciation of the shorter lived poles until the retirement of the longer lived poles.

Under SLELG, the same group of six poles would be depreciated in three separate subgroups, each group containing two poles estimated to have the same useful life. The two poles estimated to last three years would be depreciated at 33⅓ percent a year, the four year subgroup would be depreciated at 25 percent a year, and the five year subgroup would be depreciated at 20 percent per year.[2] This results in the yearly expense shown in the following table:

	Year					Total
	1	2	3	4	5	
Three year poles	$40	$40	$40	—	—	$120
Four year poles	30	30	30	30	—	120
Five year poles	24	24	24	24	24	120
Total:	$94	$94	$94	$54	$24	$360

The total depreciation expense is again $360, the total cost of the six poles. But under SLELG, full depreciation of each pole is recognized by the time of retirement of the pole. There is no deferral of the recognition of depreciation for the shorter lived poles.

Remaining Life

Assume that a new type of central-office switch first installed at the beginning of 1975 is expected to last for 20 years

[2] These depreciation rates would produce an annual depreciation expense of $20 for each three year pole ($60 x 33⅓ percent), $15 for each four year pole ($60 x 25 percent), and $12 for each five year pole ($60 x 20 percent).

and then to become obsolete even though still functioning mechanically. To eliminate problems of grouping, assume for the sake of illustration that depreciation is tracked individually for each switch. The estimated life of 20 years yields a depreciation rate of 5 percent a year. If the switch originally cost $1,000,000 and is expected to have no salvage value, a depreciation charge of $50,000 per year would be recorded.

Now assume further that after five years of depreciation has been taken amounting to $250,000 (5 years x $50,000 per year), a new technological development occurs in 1980 that makes clear that the switch will become obsolete in five more years and will be replaced in 1985, rather than in 1995 as originally estimated. If the new development had been foreseen in 1975, the estimated useful life for the switch would have been set at 10 years and the investment would have been depreciated at 10 percent per year. The question now is what kind of mid-course correction to make.

The solution used in the past, called "whole life," was to adopt in 1980 a new depreciation rate for the partly depreciated switch based on the ten year life (10 percent a year) and apply it prospectively for the remaining five years. The difficulty is that when the switch is retired at the end of 1984, the total accrued depreciation expense, denominated the "depreciation reserve," will be only $750,000.[3] On retirement there will prove to be a significant under-recovery of investment ($250,000 or 25 percent), technically a "deficiency" in the depreciation reserve.

The "remaining life" method solves this problem of under-recovery of depreciation. It provides that, when useful life of the switch is re-estimated in 1980, the *remaining* undepreciated investment ($750,000) is recovered over the course of the *remaining* useful life as it is now more accurately estimated (five more years). Since at the start of 1980 there remains 75 percent of the original investment to be recovered over the

[3] The figure represents $250,000 for 1975 through 1979 ($50,000 a year for five years) plus $500,000 from 1980 through 1984 ($100,000 a year for five years).

remaining five years, the new depreciation rate for the last five years is set at 15 percent per year (75 percent divided by 5).

At the end of the switch's useful life at the end of 1984, the total depreciation expense recorded will exactly equal the full original investment. In the example given, actual depreciation at retirement will equal $1,000,000, 100 percent of the investment.[4]

[4] Five percent a year from 1975 through 1979 (25 percent) plus 15 percent a year from 1980 through 1984 (75 percent).

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Nos. 84-871, 84-889, 84-1054, and 84-1069

In the Supreme Court of the United States

OCTOBER TERM, 1985

LOUISIANA PUBLIC SERVICE COMMISSION, APPELLANT

v.

FEDERAL COMMUNICATIONS COMMISSION AND UNITED STATES OF AMERICA

CALIFORNIA AND PUBLIC UTILITIES COMMISSION OF CALIFORNIA, ET AL., PETITIONERS

v.

FEDERAL COMMUNICATIONS COMMISSION AND UNITED STATES OF AMERICA

PUBLIC UTILITIES COMMISSION OF OHIO, ET AL., PETITIONERS

v.

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FLORIDA PUBLIC SERVICE COMMISSION, PETITIONER

v.

FEDERAL COMMUNICATIONS COMMISSION AND UNITED STATES OF AMERICA

ON APPEAL AND ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

BRIEF FOR THE FEDERAL RESPONDENTS

JACK D. SMITH
General Counsel

DANIEL M. ARMSTRONG
Associate General Counsel

JOHN E. INGLE
Deputy Associate General Counsel

JANE E. MAGO
Counsel
Federal Communications Commission
Washington, D.C. 20554

CHARLES FRIED
Solicitor General

LAWRENCE G. WALLACE
Deputy Solicitor General

CHRISTOPHER J. WRIGHT
Assistant to the Solicitor General
Department of Justice
Washington, D.C. 20530
(202) 633-2217

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QUESTION PRESENTED

Whether the court of appeals correctly held that the Federal Communications Commission acted within the scope of its authority in determining that its prescription of certain depreciation practices for telephone equipment preempted state commissions from prescribing inconsistent depreciation practices.

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No. 84-1054

PUBLIC UTILITIES COMMISSION OF OHIO, ET AL., PETITIONERS

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FEDERAL COMMUNICATIONS COMMISSION and UNITED STATES OF AMERICA

No. 84-1069

FLORIDA PUBLIC SERVICE COMMISSION, PETITIONER

v.

FEDERAL COMMUNICATIONS COMMISSION and UNITED STATES OF AMERICA

ON APPEAL AND ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

BRIEF FOR THE FEDERAL RESPONDENTS

OPINIONS BELOW

The opinion of the court of appeals is reported at 737 F.2d 388 and is reproduced in the Appendix to the Jurisdictional Statement in No. 84-871 at J.S. App. A1-A23. The order of the FCC (the *Preemption Order*) is reported at 92 F.C.C.2d 864 and is reproduced at J.S. App. A24-A60.

JURISDICTION

The judgment of the court of appeals was entered on June 18, 1984, and petitions for rehearing and suggestions of rehearing *en banc* were denied on October 3, 1984 (J.S. App. A90). The appellant in No. 84-871 filed its notice of appeal on November 30, 1984 (J.S. App. A92), and purports to invoke this Court's jurisdiction under 28 U.S.C. 1254(2). The petitions for a writ of certiorari in Nos. 84-889, 84-1054, and 84-1069 were filed on December 10, 1984, January 2, 1985, and January 2, 1985, respectively, and invoke this Court's jurisdiction pursuant to 28 U.S.C. 1254(1). The appellant in No. 84-871 asks the Court to treat its jurisdictional statement as a petition for a writ of certiorari pursuant to 28 U.S.C. 2103 if the Court determines that an appeal does not lie.[1]

STATUTES INVOLVED

The relevant portions of the Communications Act of 1934, 47 U.S.C. (& Supp. I) 151 *et seq.*, are reproduced in the appendix to this brief.

[1] The Court granted the petitions for a writ of certiorari and postponed jurisdiction on June 24, 1985. For the reasons stated in our motion to dismiss and brief in opposition (at 11-12), this case is not within the Court's appellate jurisdiction.

STATEMENT

The Communications Act of 1934 authorizes the Federal Communications Commission comprehensively to regulate interstate communications (47 U.S.C. 151, 152(a)), while reserving state jurisdiction over intrastate communications (47 U.S.C. 152(b), 221(b)). This case deals with the depreciation methods applied to telephone equipment that is used to provide both interstate and intrastate communications. In 1980 and 1981, the FCC adopted three depreciation policies for telephone equipment that are intended to bring depreciation regulation into harmony with the new competitive and technological realities of the industry. Unlike earlier FCC depreciation policies, which state regulatory agencies generally had followed, these changes were not embraced by many state agencies. On requests for clarification of the effect of the new policies on state regulation, the FCC concluded, in its *Preemption Order*, that the Act did not permit state commissions to require telephone companies to use depreciation methods and rates that are different from those prescribed by the FCC for the same equipment unless the FCC had expressly permitted exemptions for those companies. The FCC further found, as an alternative ground for preemption, that inconsistent state commission actions would frustrate the goals it sought to achieve when it adopted the new depreciation policies. The Fourth Circuit upheld the FCC's ruling on the alternative ground.

1. The Communications Act provides for complementary federal and state regulation. As a general rule, the nation's telephone companies provide interstate service under tariffs filed with the FCC and intrastate service under tariffs filed with state commis-

sions. Jurisdictional disputes under this scheme were infrequent until the mid-1970s. The FCC typically acquiesced in state regulation of most aspects of intrastate service, even where some interstate service might be affected, asserting the full breadth of its regulatory authority only where there was a need for uniformity in the rules governing jointly-used property or where federal policies might be undercut by fragmented regulation (J.S. App. A40). In recent years, however, federal policies encouraging competition sometimes have confronted state regulatory policies that are more conducive to the continued monopoly provision of services and equipment (J.S. App. A41). In several instances, the FCC has asserted its own authority as paramount and has declared conflicting state regulation invalid.[2]

This case deals with depreciation accounting, which is the process of charging the cost of depreciable property, adjusted for net salvage, to operating expense accounts over the useful life of the property. See National Association of Regulatory Utility Commissioners, *Public Utility Depreciation Practices* 35-52 (1968). Depreciation accounting affects the rates customers pay for telephone service. A regulated carrier is entitled to an opportunity to earn a fair return on its investment and to recover its reasonable expenses through its rates for service. The total amount the carrier is entitled to charge its customers, known as its "revenue requirement," is the total of its current operating expenses, including taxes and depreciation expenses, and a return on its invest-

[2] The courts uniformly have affirmed the FCC's assertions of primacy in the regulation of jointly-used communications services and facilities where the FCC's substantive actions were within its statutory authority. See pages 18-19 & note 17, *infra*.

ment rate base.[3] Depreciation accounting affects both the rate base and operating expense accounts. The original cost of a given item of equipment goes into the rate base when that item enters service. As the item depreciates over time—as a function of "wear and tear" or technological obsolescence—the amount in the rate base is reduced according to a schedule that is based on the item's expected useful life. Each year the amount removed from the rate base is included as an operating expense.[4] The annual depreciation charges accumulate in an account known as the depreciation reserve, which should equal the depreciable cost of the item at the end of the process. The depreciation reserve is a measure of the extent to which the carrier has recovered its investment in equipment. See P. Garfield & W. Lovejoy, *Public Utility Economics* 94-114 (1964).

The Act gives the FCC authority to prescribe depreciation practices for communications carriers. Section 220(b) authorizes the FCC to prescribe "classes of property" for which depreciation may be charged and to prescribe depreciation procedures; it states that the carriers "shall not" use any other

[3] Regulators can affect the size of the revenue requirement in various ways. They can, for example, disallow specific expenses, disallow inclusion of items in the rate base, and alter the rate of return allowed on the rate base. See P. Garfield & W. Lovejoy, *Public Utility Economics* 44-83 (1964).

[4] For example, a truck with an original cost of $10,000 and an expected life of ten years enters the rate base as a $10,000 item to be depreciated over ten years. If we assume for the sake of simplicity that the truck has no salvage value, each year's depreciation would diminish the rate base by $1,000 and add an expense charge of $1,000 to the revenue requirement for that year.

classifications or depreciation procedures. The FCC is required, before prescribing any depreciation procedures, to "notify each State commission" and to "receive and consider" the views and recommendations of such commissions (Section 220(i)). The FCC may except the carriers in any state from its prescribed depreciation procedures, where such carriers are subject to state commission regulation, "if it deems such action consistent with the public interest" (Section 220(h)).

The FCC prescribes depreciation rates on a company-by-company basis for about one-third of the nation's largest telephone companies every year; thus, the depreciation rates for each of these companies are revised every three years. A practice has developed over the years in which representatives of the FCC, individual carriers, and the appropriate state commission hold "three-way meetings" to develop depreciation rates that are consistent with the FCC's more general depreciation policies before the FCC actually prescribes particular rates for individual carriers. See, *e.g.*, *Prescription of Revised Percentages of Depreciation*, 88 F.C.C.2d 1223, 1225 (1982). Through those meetings, the FCC generally has been able to accommodate the special concerns of state commissions without compromising its own depreciation policies unduly. The FCC has allowed exceptions from general rules for carriers in particular states, as Section 220(h) permits, where that would not undermine federal policy or conflict with the public interest. See, *e.g.*, *In re Amendment of Part 31*, 68 F.C.C.2d 902, 906-907 (1978).

2. The two substantive FCC orders that preceded the *Preemption Order* made three changes in the agency's depreciation prescriptions. In *In re Property Depreciation (ELG Order)*, J.A. 4-44, reconsideration denied, J.A. 45-65, the FCC substituted "equal life group" (ELG) depreciation in place of "vintage grouping." [5] Grouping of telephone company equipment for depreciation purposes is required because telephone companies have so many individual items of equipment that it is not practical to depreciate each item individually. Under vintage grouping all items of a similar type installed in a year are depreciated over the average useful life for the group, even though the group might contain equipment with widely varying life expectancies. Under the equal life group method, the groups are smaller and include only those items whose expected lives are

[5] The Commission initiated this proceeding in response to a petition by the American Telephone and Telegraph Company, which had argued that its depreciation reserve under the old depreciation policies did not reflect the true rate of decrease in the value of its plant in the new era of competition and technological innovation. J.A. 4-6. The Commission considered AT&T's request in light of several rounds of comments from the industry, accounting firms, and state regulatory commissions; an independent accounting study commissioned by the FCC; and revenue impact studies by the two largest telephone carriers. J.A. 6-7. In general, the telephone carriers and accounting firms supported depreciation reform, and the state commissions opposed any change. Although the FCC generally adopted the depreciation methods advocated by the carriers, it took several actions to accommodate state concerns. For example, it permitted ELG accounting methods prospectively only and phased in the new policies so as to mitigate their potential impact on ratepayers and lessen the additional work burden they would impose on state regulators. J.A. 29-30. It also directed its staff to monitor the effects of the new policies on rates and to inform the Commission of any significant rate increases that might be attributable to the changes. J.A. 35-36.

approximately equal.[6] The principal advantages of the ELG method are greater accuracy in allocation of costs and faster capital recovery for equipment with shorter lives. J.A. 23.[7]

The second revision in the *ELG Order*—adoption of the "remaining life" method in place of the "whole life" method (J.A. 33-36)—deals with the problem of correcting for errors in forecasts of useful life. Under the whole life approach, the FCC had required carriers to calculate depreciation charges each year as if the useful life of assets had been correctly estimated from the beginning, even when that estimate had been erroneous. Under whole life accounting, when there was an error in the initial life estimation, the assets affected by the error would be either under-recovered or over-recovered at the time of their retirement.[8] The remaining life method permits a correction for erroneous forecasts of the length of useful life. This method permits carriers to allocate any unrecovered depreciation over the corrected remaining life estimate and helps overcome the depreciation reserve deficiencies that had become evident in the modern telephone industry.[9]

[6] For example, a vintage group might include all the new cable purchased in a given year, even though some of the cable might be expected to last several times as long as some other cable. The "life" for the vintage group would be the average life for all items in the group. In contrast to vintage grouping, there might be several equal life groups of cable for a single year. Equal life groups might include all the new outdoor cable purchased in a given year, with an expected useful life of five years, and all the new indoor cable purchased in a given year, with an expected useful life of fifteen years.

[7] The depreciation method is the same under equal life and vintage grouping: straight-line depreciation over the average life of the items in the group.

[8] In the industry environment that existed until the late 1960s, these errors tended to balance out. The FCC found, however, that new technology and competition had changed this through an overall shortening of useful lives. J.A. 34. Thus, it was no longer valid to assume that errors of overestimation and underestimation were "self balancing." *Ibid.*

The Commission anticipated that these depreciation policies would produce more timely capital recovery for telephone carriers and result in faster technological innovation with accompanying benefits for the public—such as more efficient service and eventually lower costs from more productive use of telephone facilities. J.A. 23-24. It recognized that the new policies would likely produce a temporary increase in telephone rates (J.A. 23, 35), but it concluded that the longer-term costs to society of maintaining the existing system far outweighed the short-term advantages of holding down depreciation expenses. If it did not initiate depreciation reform, the Commission said, much larger adjustments would be necessary at some future date. J.A. 40.

[9] For example, an asset might be depreciated at 10% a year on the assumption that it would last for ten years. In the fourth year, after 30% depreciation, the "correct" useful life estimate might be revised to five years because of technological or competitive developments that would hasten the asset's obsolescence. Under the whole life method, the depreciation for the fourth and fifth years would be adjusted to 20% a year, on the new assumption that it was known all along that the asset would last only five years. But the total depreciation for this asset under that method would be only 70% of the depreciable cost—30% for the first three years and 40% for the last two. Under the remaining life method, the depreciation for each of the last two years in this example would be 35%, so as to recover all of the depreciable cost that remained unrecovered when the correction was made.

In *In re Uniform System of Accounts (Inside Wiring Order)*, 85 F.C.C.2d 818 (1981), the FCC determined that one class of property it earlier had prescribed as depreciable—inside wiring[10]—no longer should be capitalized and depreciated but should instead be treated as a current expense. Like the *ELG Order*, the *Inside Wiring Order* had its origins in relatively recent developments in communications markets and technology. The FCC decided that continuing to depreciate this expenditure over time had the same potential for out-of-phase capital recovery and for misallocation of costs among customers that had prompted the changes to equal life grouping and remaining life depreciation, and so it removed inside wiring from the prescribed list of depreciable property.[11]

[10] "Inside wiring" for purposes of this decision includes the costs of material and labor associated with the installation of wire inside the premises of a business or residence. It does not include categories of wire that are considered permanent and might properly be capitalized as investment in plant. 85 F.C.C.2d at 823-826.

[11] Competitive provision of many of the elements of station connections, including inside wiring, had made it necessary for the FCC to consider the propriety of continuing to impose such costs on the general body of ratepayers through capitalization and depreciation charges. The FCC decided that customers who had obtained station connections from sources other than the telephone company should not have to pay telephone rates that include depreciation and a return on investment generated by the telephone company's provision of station connections for other customers. The FCC already had concluded in a 1977 rate decision that "the causative ratepayer should bear the full burden of the costs of station connections." *In re AT&T*, 64 F.C.C.2d 1, 54-56 (1977). See also *Inside Wiring Order*, 85 F.C.C.2d at 819-820 (1979).

3. Although the FCC and the state commissions participating in these proceedings clearly anticipated an immediate effect on both interstate and intrastate rates (J.A. 23, 35), no one sought review of either the *ELG Order* or the *Inside Wiring Order*. However, two parties representing state commissions asked the FCC to clarify the preemptive effect of its depreciation decisions.[12] The Commission first decided, by a 4-3 vote, that its depreciation orders did not require the state commissions to follow the federal policy in their ratemaking proceedings.[13] On reconsideration the Commission unanimously ruled that state commissions had to follow the federal depreciation orders (J.S. App. A24-A60).[14]

The FCC decided on reconsideration that Section 220 of the Communications Act forecloses the states from adopting depreciation rates different from those the FCC has prescribed unless the FCC expressly has

[12] NARUC Petition for Clarification (in CC Docket No. 79-105) (filed Apr. 30, 1981); California PUC Petition for Reconsideration (in CC Docket No. 79-105) (filed Apr. 29, 1981).

[13] The Commission in that first decision held that Section 220 of the Communications Act in itself did not preempt the states from adopting accounting procedures that were different from those prescribed by the FCC (J.S. App. A61-A62). The majority recognized that the FCC's actions under Section 220 could preempt "state regulatory actions that might interfere with or tend to frustrate policies or rules we have adopted," but it saw "no occasion" to override state actions in this instance (J.S. App. A84).

[14] The FCC also granted a petition for a declaratory ruling, at the request of General Telephone Co. of Ohio, declaring that the Ohio Public Utilities Commission had acted inconsistently with the *ELG Order* when it had refused to allow rate increases that sought to implement the new depreciation rules (J.S. App. A48-A49).

excepted the carriers in particular states from its prescriptions. The Commission noted that, under the plain language of the statute, "the Commission 'shall' make depreciation prescriptions, and * * * carriers 'shall not' charge depreciation different than that prescribed by the Commission" (J.S. App. A32). The Commission added that other provisions of Section 220 are consistent with this plain language—Section 220(i) requires that "states be given an opportunity to comment" before the FCC prescribes depreciation practices (J.S. App. A32) and Section 220(h) gives the FCC discretionary authority to grant exceptions to its depreciation prescriptions for carriers in a particular state "if it deems such action consistent with the public interest" (J.S. App. A32). The legislative history also supports a plain reading of Section 220(b), the Commission concluded, because Congress considered and rejected a provision that would have given states the power to prescribe separate depreciation rules for intrastate purposes (J.S. App. A35-A37).

Alternatively, the FCC found that even if the statute itself does not preempt the states, preemption is necessary in this case to avoid frustration of the federal policies the FCC had adopted. The FCC had adopted its new depreciation rules to rationalize capital recovery throughout the entire telephone industry. Rational capital recovery, it concluded, was necessary to ensure continued development of the national telephone system and to further the FCC's policy of "encouraging competition wherever the market conditions will support such a policy and produce benefits to the public interest" (J.S. App. A44). The new depreciation prescriptions, it said, were needed to make the "marketplace * * * operate efficiently"

(*ibid.*). The Commission concluded that inconsistent state depreciation rules could give "improper signals * * * to the market" (J.S. App. A45). Indeed, since 75% of the cost of the affected equipment is allocated to the intrastate jurisdiction under separations procedures (see 47 U.S.C. 221(c), 410(c)), adoption of inconsistent depreciation measures by the states would likely "delay or prevent modernization" and could imperil the full recovery by the carriers of their invested capital (J.S. App. A46). The FCC concluded that "it is essential to preempt inconsistent state depreciation practices to avoid frustration of * * * vital national policies" (J.S. App. A48).[15]

4. The Fourth Circuit affirmed the FCC's *Preemption Order*, with one judge dissenting. The court of appeals found it "unnecessary to decide" whether Section 220(b) requires preemption as a matter of law (J.S. App. A8). Instead, relying primarily on this Court's decision in *Fidelity Federal Savings & Loan Ass'n* v. *de la Cuesta*, 458 U.S. 141 (1982), the court of appeals held that the FCC had lawfully exer-

[15] The FCC's concern that some states would not follow its depreciation prescriptions, already evident to some extent when it adopted the *Preemption Order*, has proven correct. Although an appellate review proceeding was initiated promptly in a court with jurisdiction to stay the FCC's *Preemption Order*, not one of the many state parties involved in that proceeding sought a stay. Yet a number of state commissions ignored both the substantive depreciation orders and the subsequent preemption decision in denying telephone company rate changes that were designed to carry out the FCC's prescriptions. See, *e.g.*, *Chesapeake & Potomac Telephone Co.* v. *Public Service Commission*, 560 F. Supp. 844 (D. Md. 1983), aff'd, 748 F.2d 879 (4th Cir. 1984), cert. granted, No. 84-1362 (June 24, 1985). That case will be argued in tandem with the present one.

cised its discretionary power to preempt so as to avoid frustration of valid federal policies. Under *de la Cuesta*, the court of appeals noted, the test is whether the FCC "meant to preempt, and whether such preemptive action is within the scope of the agency's authority" (J.S. App. A10, citing 458 U.S. at 154). Since the FCC clearly intended to preempt, the only issue was whether the FCC had acted within the scope of its authority.

The court noted that "improper capital recovery does pose a true threat in today's competitive market" (J.S. App. A12). The court recognized that the effects of inconsistent state depreciation regulation would not be limited to matters confined to the intrastate jurisdiction. If state depreciation practices failed to reflect actual depreciation rates properly, "interstate service would then suffer the effects of delayed innovation" because the same equipment is used for interstate and intrastate purposes (J.S. App. A13-A14). The court of appeals acknowledged that the FCC's decision would affect intrastate rates, but it held that "the effect will only be ancillary to the FCC's primary statutory directive to regulate interstate communications" (J.S. App. A11). The Fourth Circuit noted that its own prior decisions and those of other circuits uniformly permitted preemption by the FCC when that was necessary to advance federal policies, even though preemption would affect intrastate rates (J.S. App. A14-A16). The court concluded that the FCC had acted "within its authority to ensure efficient operation of the interstate telephone network" and that its preemption of inconsistent state regulation was therefore valid (J.S. App. A11).

SUMMARY OF ARGUMENT

The FCC may preempt states from requiring telephone companies to use depreciation methods and rates that are inconsistent with those prescribed by the FCC if its decision is reasonable and within the scope of its authority. The FCC's *Preemption Order* was a reasonable decision within the scope of its comprehensive mandate to make available an efficient national telephone network. Indeed, there can be no doubt about the FCC's authority to prescribe preemptive depreciation methods and rates, since Section 220 of the Communications Act plainly gives the FCC exclusive authority over depreciation practices unless the FCC determines that regulation by a state commission promotes the public interest. Contrary to petitioners' arguments, Section 152(b), which reserves state authority over purely intrastate matters, does not prohibit the FCC from prescribing preemptive depreciation methods and rates.

A. Section 151 of the Act directs the FCC to develop a national telephone network and Section 152(a) gives the FCC broad jurisdiction over interstate communications. The courts of appeals have recognized that these provisions give the FCC paramount authority over matters affecting interstate telephone service. In its substantive depreciation orders, the FCC reasonably determined that the changes it ordered promoted vital national policies, including timely recovery of capital invested in telephone equipment. Delayed capital recovery would discourage investment in modern equipment and therefore delay modernization. The goals the FCC sought to achieve in those orders would be frustrated if state commissions could order telephone companies to use different depreciation methods on telephone

equipment used jointly for interstate and intrastate communications.

B. Section 220(b) of the Act demonstrates beyond doubt that depreciation practices are within the scope of the FCC's authority. That section plainly states that once the FCC has prescribed depreciation methods and rates, telephone companies "shall not" use other methods and rates. The legislative history shows that Section 220(b) means what it says. The section was modeled on a provision of the Interstate Commerce Act that had been construed as providing exclusive federal authority over the depreciation practices of telephone companies. Representatives of state commissions recognized that and proposed that the Communications Act reserve authority to state commissions over depreciation rates to be used in intrastate ratemaking proceedings. Congress gave careful attention to that proposal and rejected it. Instead, Congress provided that state commissions must be consulted by the FCC before it prescribes depreciation methods and rates and authorized the FCC to permit state commissions to set depreciation rates where the FCC determines that such a course is in the public interest.

C. Petitioners' argument is based almost entirely on Section 152(b), which reserves state authority over intrastate communications. However, it is clear that the general provisions of Section 152(b) do not override the specific commands of Section 220(c). Moreover, as the courts of appeals have determined, Section 152(b) reserves state authority over purely intrastate matters only. This dispute does not involve a purely intrastate matter, because the telephone equipment involved is used for interstate and intrastate communications and state regulation could

frustrate federal policy. At most, Section 152(b) was designed to reserve state authority over the rates charged to customers for intrastate service, and the FCC has not usurped that authority.

ARGUMENT

THE FCC ACTED WITHIN THE SCOPE OF ITS AUTHORITY IN PREEMPTING STATE COMMISSIONS FROM REQUIRING TELEPHONE COMPANIES TO USE DEPRECIATION PRACTICES THAT ARE INCONSISTENT WITH THOSE PRESCRIBED BY THE FCC

A federal agency acting within its statutory authority may preempt inconsistent or conflicting state actions by virtue of the Supremacy Clause. See *Fidelity Federal Savings & Loan Ass'n* v. *de la Cuesta*, 458 U.S. 141 (1982). As this Court recently stated in *Capital Cities Cable, Inc.* v. *Crisp*. No. 82-1795 (June 18, 1984), slip op. 7, "[i]f the FCC has resolved to pre-empt an area of * * * regulation and if this determination 'represents a reasonable accommodation of conflicting policies' that are within the agency's domain, * * * we must conclude that all conflicting state regulations have been precluded" (quoting *United States* v. *Shimer*, 367 U.S. 374, 383 (1961)). The FCC's decision to preempt inconsistent state depreciation practices was permissible under this standard.

A. Section 151 Authorizes The FCC To Preempt In Order To Improve Interstate Telephone Service

Congress created the FCC for the purpose of centralizing in one agency the task of overseeing the communications industry in the United States and developing communications policies for wire and radio on an integrated basis. H.R. Rep. 1850, 73d

Cong., 2d Sess. 3 (1934). It gave the Commission "a comprehensive mandate" with "expansive powers." *National Broadcasting Co.* v. *United States*, 319 U.S. 190, 219 (1943). Congress directed the Commission to use its authority to make available a "rapid, efficient, Nation-wide, and world-wide wire and radio communication service." 47 U.S.C. 151. It made clear that the FCC's jurisdiction extends to "all interstate and foreign communication by wire or radio." 47 U.S.C. 152(a).

1. The federal courts of appeals have consistently recognized that the FCC is authorized to preempt inconsistent state practices in order to achieve the goals set forth in Section 151. For example, the Fourth Circuit's decision in *North Carolina Util. Comm'n* v. *FCC*, 537 F.2d 787, cert. denied, 429 U.S. 1027 (1976) (*NCUC I*), involved the issue of whether telephone terminal equipment supplied by the customer rather than by the telephone company could be connected to the telephone network. Two state commissions had indicated that such equipment could not be attached to facilities used for intrastate service, and the FCC ruled that the state prohibitions were preempted by federal policies permitting interconnections for interstate service (537 F.2d at 790). The court of appeals determined that "it is not feasible * * * to limit the use of such equipment to either interstate or intrastate transmissions" (*id.* at 791). Accordingly, the FCC's policies "unavoidably affect[ed] intrastate as well as interstate communication" and, by the same token, both interstate and intrastate communications would be affected by state action preventing connection of customer provided equipment (*id.* at 792). In these circumstances, the court held, the FCC must be permitted to preempt the states.

The District of Columbia Circuit came to a similar conclusion in *Computer & Communications Industry Ass'n* v. *FCC*, 693 F.2d 198 (D.C. Cir. 1982), cert. denied, 461 U.S. 938 (1983), which involved the FCC's deregulation of customer premises terminal equipment (CPE) and some aspects of enhanced communications services.[16] The FCC declared that state commissions were preempted from regulating CPE and enhanced services. As the court of appeals explained, "[t]he conflict between federal and state power over CPE arises because most CPE in this country is used interchangeably for both interstate and intrastate communication and has traditionally been subject to both state and federal regulation" (693 F.2d at 214). If states regulated CPE and enhanced services under interstate tariffs, that would conflict with the FCC's goal of establishing a competitive market for CPE and enhanced services (*id.* at 215). The court of appeals concluded that "the Commission's jurisdiction is paramount and conflicting state regulations must necessarily yield to the federal regulatory scheme" (*id.* at 214; footnotes omitted).[17]

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[16] "Enhanced service" typically involves access to information stored in a computer. It is contrasted with "basic service," the transmission of communications. See 693 F.2d at 205 n.18.

[17] A number of other decisions have upheld the FCC's authority to preempt. *E.g., New York Tel. Co.* v. *FCC*, 631 F.2d 1059 (2d Cir. 1980); *California* v. *FCC*, 567 F.2d 84 (D.C. Cir. 1977), cert. denied, 434 U.S. 1010 (1978); *Puerto Rico Tel. Co.* v. *FCC*, 553 F.2d 694 (1st Cir. 1977); *North Carolina Util. Comm'n* v. *FCC*, 552 F.2d 1036 (4th Cir.), cert. denied, 434 U.S. 874 (1977) (*NCUC II*); *Sherdon* v. *Dann*, 193 Neb. 768, 229 N.W.2d 531 (1975); cf. *General Tel. Co.* v. *FCC*, 449 F.2d 846 (5th Cir. 1971).

2. As the Fourth Circuit recognized in this case, the FCC's depreciation orders were devised to help achieve the objectives set forth in Section 151 (J.S. App. A11).[18] After extensive rulemaking proceedings in which it received and considered comments from state commissions and independent analysts as well as industry representatives, the FCC found that changes in the nature of the industry mandated changes in its depreciation policies. The Commission determined that its new policies would speed the re-

[18] Citing this Court's decision in *Pacific Gas & Electric Co.* v. *State Energy Resources Conservation & Development Comm'n*, 461 U.S. 190 (1983), petitioners contend (Cal. Br. 29) that the FCC and the Fourth Circuit could not look to the broad mandate of Section 151 to justify preemption. *Pacific Gas & Electric Co.* is clearly distinguishable, however. In that case California had adopted a statute which effectively prevented construction of new nuclear power plants until some effective plan for dealing with nuclear waste was devised. In the face of a federal statute that "allowed the States to determine—as a matter of economics—whether a nuclear plant vis-a-vis a fossil fuel plant should be built" (*id.* at 222) and limited federal regulation to safety regulation (*id.* at 207-208, 212), this Court concluded that the broad purpose of the Atomic Energy Act to promote the use of nuclear power was an insufficient basis for preemption of the California statute. The Communications Act is not analogous to the Atomic Energy Act. The FCC is not restricted to a narrow concern such as safety regulation and the states are not given authority to control the development of the telephone network. On the contrary, the FCC has a "comprehensive mandate" and "expansive powers" (*National Broadcasting Co., supra*, 319 U.S. at 219). In addition, as we show (pages 23-32, *infra*), Section 220 of the Communications Act grants the FCC specific authority over depreciation rates. Thus, preemption in this case is not based merely on the FCC's broad authority under Section 151, but on the combination of that authority and the agency's specific authority under Section 220.

covery of capital, provide incentives to modernize plant, simplify regulation and make it more rational, and impose costs more nearly on the users who caused them. These are legitimate regulatory objectives within the FCC's broad mandate.[19]

Petitioners suggest that because regulators traditionally have separated the costs of jointly-used facilities there need not be a conflict here since the FCC could confine its depreciation regulation to the portion assigned to the interstate jurisdiction. *E.g.*, La. Br. 40-41; National Conference of State Legislators Br. 14. In their view, any conflict is removed if the telephone companies maintain one set of accounts for

[19] Claims to the contrary by the petitioners are based on assertions that the FCC's policies will not achieve their goals. Petitioners argue, for example, that faster depreciation will frustrate the FCC's plans because it will produce higher rates and discourage the use of carrier facilities. Cal. Br. 37; TRACER Br. 10-16. As an initial matter, the FCC was aware that its actions likely would result in short-term rate increases and it took that fact into consideration when it made its policy changes. See *ELG Order*, J.A. 23, 35. The FCC concluded that on balance the long-term benefits to the public of rational depreciation policies outweighed the short-term costs. In any event, such arguments provide no basis for overturning the FCC's *Preemption Order* because they challenge the wisdom of the substantive depreciation policies rather than the lawfulness of preemption. The FCC's depreciation policies rest on precisely the kind of predictive judgment that is committed to the FCC's discretion (and that is, of course, subject to future re-evaluation by the FCC in the light of experience). See *FCC* v. *WNCN Listeners Guild*, 450 U.S. 582, 595 ([illegible]; *American Tel. & Tel. Co.* v. *United States*, 299 U.S. 232 (1936). Moreover, as we pointed out above, no party sought review of the FCC's substantive depreciation decisions. They may not now ask the courts to second-guess those decisions in a case that concerns the preemptive effect of the FCC's depreciation policies.

the FCC and another for state commissions. It is apparent, however, that the goals the FCC sought to achieve with its depreciation policies could be frustrated by inconsistent state depreciation practices, just as the state actions that were preempted in *NCUC I* and *Computer & Communications Industry Ass'n* could have impeded the achievement of federal goals. As the FCC pointed out, approximately 75% of the cost of jointly-used plant is allocated to the intrastate jurisdiction. The FCC's objective of allowing carriers adequate capital recovery to enable them to modernize their facilities could not be achieved if the FCC's substantive depreciation policies applied only to 25% of the cost of the network. Inconsistent state depreciation practices that delay recovery of capital would discourage investment in new equipment, thus slowing modernization of the interstate as well as the intrastate telephone network.[20] In short,

[20] Therefore, it is not inconsistent for the FCC to permit state commissions to authorize carriers to use depreciation rates for intrastate ratemaking that permit faster capital recovery than those adopted by the FCC, as Louisiana suggests (Br. 29). The FCC's objectives are not undermined by state regulation permitting faster capital recovery. In any event, no one has complained to the FCC of such state regulation and the FCC has not expressly approved or disapproved of it.

Nor is there merit to petitioners' suggestion (La. Br. 29) that the *ELG Order* cannot be preemptive because the order itself is merely permissive, allowing, but not requiring, carriers to adopt equal life group and remaining life procedures. The FCC order was optional because some carriers lack the extensive data bases and data processing resources needed to use these methods. J.A. 36, 40. State action which *forbids* the carriers to do that which the FCC deliberately and expressly has *permitted* them to do is in conflict with the federal order and thus may be preempted. See *New York State Comm'n* v. *FCC*, 669 F.2d 58, 66 (2d Cir. 1982) (federal regulation which is permissive in its approach may preempt restrictive state regulation). In any event, the FCC's subsequent prescription orders for individual companies made the use of the new procedures mandatory where feasible. *E.g., Prescription of Revised Percentages of Depreciation*, 96 F.C.C.2d 257 (1983).

the depreciation policies adopted by the FCC will not achieve the agency's legitimate objectives unless state commissions follow them. And, as events following the issuance of the *Preemption Order* illustrate, state commissions, which are generally under great pressure to keep customer rates low, may sacrifice the long-term efficiency of the telephone network to short-term goals.[21] In light of the FCC's powers under Section 151 and its broad jurisdiction under Section 152(a), the FCC acted within the scope of its authority in preempting the states from requiring telephone companies to use inconsistent depreciation methods.[22]

B. Section 220 Plainly Authorizes The FCC To Preempt Inconsistent State Practices Regarding Depreciation Methods And Rates

Any doubt about the FCC's authority to preempt in this case is laid to rest by Section 220. Section 220(b) plainly authorizes the FCC to issue preemptive orders regarding depreciation methods and rates.

[21] Congress recently noted that state commissions, "in an effort to keep local rates low," have favored depreciation methods that do not "encourage modernization." H.R. Rep. 98-479, 98th Cong., 1st Sess. 53 (1983).

[22] California also argues (Br. 5) that states must retain control over depreciation charges because the FCC cannot take account of local conditions in making depreciation prescriptions. This argument ignores the fact that although the Commission has adopted general policies that apply nationwide, it makes individual prescriptions for telephone companies in consultation with state commissions. The FCC does not mechanically prescribe depreciation rates without regard to local conditions.

The legislative history of Section 220 and its structure show that Congress intended the FCC to prescribe preemptive depreciation rates.

1. Section 220(b) directs the FCC to prescribe depreciation methods and rates for carriers subject to the Act. It plainly states that those depreciation prescriptions are exclusive: once the FCC prescribes depreciation rates for carriers subject to the Act, "[s]uch carriers shall not * * * charge to operating expenses any depreciation charges on classes of property other than those prescribed by the Commission, or * * * charge with respect to any class of property a percentage of depreciation other than that prescribed therefor by the Commission." Section 220 reserves no complementary authority for state commissions.[23] Thus, under the standard assumption that " 'the legislative purpose is expressed by the ordinary

[23] This is in contrast to sections of the Act which do expressly confine the FCC's regulatory authority to interstate and foreign communications. See, *e.g.*, Section 201(a) ("every common carrier engaged in interstate or foreign communications" must furnish service on reasonable request); Section 203(a) (carriers must file tariffs with the FCC "for interstate and foreign * * * communications"); Section 214(a) (requirement of FCC certificate for new lines does not apply to "a line within a single State unless such line constitutes part of an interstate line").

Amici contend that Section 220 does distinguish between interstate and intrastate facilities because it applies to "carriers subject to the Act." *E.g.*, Alabama Br. 6. The assumption underlying this contention is that local exchange carriers are not subject to the Act. However, virtually all carriers are "subject" to some substantive provisions of the Act. Section 152(b) provides that even those local carriers "engaged in interstate or foreign communication solely through physical connection with the facilities of another carrier" are subject to Sections 201 through 205, the ratemaking provisions of the Act.

meaning of the words used' " (*Kosak* v. *United States*, No. 82-618 (Mar. 21, 1984), slip op. 5, quoting *American Tobacco Co.* v. *Patterson*, 456 U.S. 63, 68 (1982), and *Richards* v. *United States*, 369 U.S. 1, 9 (1962)), the FCC has authority to issue preemptive depreciation prescriptions.

Petitioners complain (see La. Br. 37-38) that the FCC did not claim the authority to issue preemptive depreciation prescriptions for almost 50 years, contending that the delay shows that it thought it lacked power to preempt. The actual history of past practice does not support this contention. Although the FCC had not ruled previously on the preemptive effect of its depreciation prescriptions, there had been no occasion to do so. The preemption issue had not arisen because the states generally had gone along with the FCC's prescriptions. The state commissions participated in general prescription proceedings and in the three-way meetings to set depreciation rates for individual carriers, and there had been no direct challenges to the FCC's prescription orders. The FCC had made clear that it would not object to minor departures from its accounting rules so long as there was no conflict, giving blanket approval to state-required "subaccounts" provided the subaccounts did not impair the integrity of the uniform accounting system. See 47 C.F.R. 31.01-2(d)(1). Such accommodations, obviously, are as consistent with the existence of preemptive authority as with its absence.

Nor does the FCC's first decision in this case show that it lacks power to preempt. The evolution of this case shows only that FCC was not eager to preempt. In its original order, the FCC found "no occasion" to preempt because it believed that the states would act in a way that was reconcilable with federal policies.

The FCC declared its rulings to have preemptive effect only after it became clear that state commissions would not follow them (J.S. App. A46 n.14, A48-A49). Moreover, the FCC "is not disqualified from changing its mind; and when it does, the courts still sit in review of the administrative decision and should not approach the statutory construction issue *de novo* and without regard to the administrative understanding of the statutes." *NLRB* v. *Local Union No. 103*, 434 U.S. 335, 351 (1978).[24]

2. a. The legislative history of Section 220 establishes beyond doubt that the FCC's authority to prescribe depreciation methods and rates includes authority to preempt inconsistent state practices. Congress modeled Section 220 on Section 20 of the Interstate Commerce Act, 49 U.S.C. (1976 ed.) 20 (repealed). S. Rep. 781, 73d Cong., 2d Sess. 5 (1934); H.R. Rep. 1850, 73d Cong., 2d Sess. 7 (1934). Congress had amended Section 20 in 1920, directing the Interstate Commerce Commission to prescribe depreciation methods and rates for telephone companies. *Northwestern Bell Telephone Co.* v. *Nebraska State Ry. Comm'n*, 297 U.S. 471, 477 (1936). The ICC viewed its powers under Section 20 as covering "local

[24] The statement of the California Supreme Court that the California commission was "not bound by the depreciation rates or methods" set by the FCC (*Pacific Tel. & Tel. Co.* v. *California*, 44 Cal. Rptr. 1, 20-21, 401 P.2d 353, 372-373 (1965)), which petitioners cite (Cal. Br. 3; La. Br. 27), does not support petitioners' argument. That statement was made without any analysis of Section 220 and its history and without participation by the FCC. Moreover, the court was dealing with a minor point in a broad dispute. Its statement does not indicate any general understanding that the FCC could not issue preemptive depreciation prescriptions.

properties of telephone companies where used to some extent in interstate toll service." *Depreciation Charges*, 118 I.C.C. 295, 330-333 (1926). In short, Congress modeled Section 220(b) on a provision that the ICC had determined to be preemptive and stated plainly, in the text of the statute, that the depreciation methods and rates to be prescribed by the FCC were to be exclusive (see page 24, *supra*). Thus, the FCC's decision that the depreciation practices it prescribed preempt inconsistent state practices is expressly authorized by Congress.[25]

b. That the FCC has authority to preempt in this case is shown with particular clarity by the fact that in 1934 Congress specifically rejected a proposal that would have given the state commissions the authority they now seek. As orginally proposed, Section 220 included a new subsection, Section 220(j), that would have reserved to the states the authority to set depreciation rates for intrastate ratemaking purposes. Section 220(j), as proposed, provided that nothing in the statute would "limit the power of a State commission to prescribe, for the purposes of the exercise of its jurisdiction with respect to any carrier, the percentage rate of depreciation to be charged to any

[25] The cases decided by this Court construing Section 20 do not show that it did not grant the ICC preemptive authority, as petitioners suggest (Cal. Br. 20; La. Br. 3-4). The Court in those cases decided only that "until the Interstate Commerce Commission has prescribed depreciation rates the prerogative of the state to regulate such rates cannot be gainsaid." *Northwestern Bell, supra*, 297 U.S. at 479; *Smith* v. *Illinois Bell Telephone Co.*, 282 U.S. 133, 159-160 (1930). Indeed, the language used by the Court suggests that once the ICC acted the states would be preempted. See *New York Tel. Co.* v .*FCC*, 631 F.2d at 1066-1067.

class of property." [26] The House Committee report and the House bill's sponsor in floor remarks acknowledged that Section 220(j) as proposed would "change" the existing law by removing limitations in Section 20 of the Interstate Commerce Act on the authority of the states to prescribe rates of depreciation. H.R. Rep. 1850, 73d Cong., 2d Sess. 7 (1934); 78 Cong. Rec. 10314 (1934) (remarks of Rep. Rayburn).

Opposition to that change was voiced at the Senate hearings on the bill. The president of AT&T vigorously attacked the new subsection, claiming that it, along with subsection (h)—which authorizes the FCC to exempt carriers from federal requirements where they are subject to state regulation—"strike down practically all the sound and salutatory provisions of the preceding paragraphs, and introduce chaos."

[26] Section 220(j), as initially proposed in S.2910, 73d Cong., 2d Sess. (1934) and H.R. 8301, 73d Cong., 2d Sess. (1934), provided:

> (j) Nothing in this section shall (1) limit the power of a State commission to prescribe, for the purposes of the exercise of its jurisdiction with respect to any carrier, the percentage rate of depreciation to be charged to any class of property of such carrier, or the composite depreciation rate, for the purpose of determining charges, accounts, records, or practices; (2) relieve any carrier from keeping any accounts, records, or memoranda which may be required to be kept by any State commission in pursuance of authority granted under State law.

This language is strikingly similar to language that Congress enacted in almost contemporaneous legislation dealing with depreciation regulation in the natural gas and electric power industries. See Section 9(a), 15 U.S.C. 717h(a) (Natural Gas Act); Section 302(a), 16 U.S.C. 825a(a) (Federal Power Act). The rejection of this language in the Communications Act indicates that Congress made a different decision with respect to the communications industry.

Federal Communications Commission: Hearings on S. 2910 Before the Senate Comm. on Interstate Commerce, 73d Cong., 2d Sess. 96 (1934) [hereinafter cited as *Senate Hearings*]. Noting the conflict between subsections (b) and (j), he described the section as "mak[ing] an orderly advance and then beat[ing] a disorderly retreat" (*ibid.*). The committee took careful note of these objections, asking the president of the United States Independent Telephone Association and the chairman of the legislative committee of the National Association of Railroad and Utilities Commissioners (NARUC) to respond to them (*id.* at 140, 154). The ICC responded in writing, one day after the conclusion of the Senate hearings, stating that Section 220(j) "unquestionably directly conflicts with, and destroys the uniformity of systems of accounts and depreciation accounting required by the preceding provisions of the section. That is not true under present law" (*Senate Hearings* 208). The ICC advised that this change "should be most carefully considered" (*ibid.*). The Senate responded by drafting a new subsection (j) providing that the FCC "shall investigate and report" on whether state commissions should be permitted to prescribe depreciation rates.[27]

[27] The Senate revised Section 220(j) to provide:

> (j) The Commission shall investigate and report to the Congress whether in its opinion legislation is desirable (1) authorizing the Commission to except the carriers of any particular class or classes in any State from any of the requirements under this section in cases where such carriers are subject to State commission regulation with respect to matters to which this section relates; and (2) permitting the State commissions, in pursuance of authority granted under State law, to prescribe their own percentage rates of depreciation or systems of accounts, records, or memoranda to be kept by carriers.

The House held hearings on the proposed legislation after the Senate had revised Section 220(j). The House bill under consideration retained the version of Section 220(j) that authorized state commissions to prescribe depreciation practices. The chairman of NARUC's legislative committee stated that he opposed the Senate's revision, stating that the Senate bill "has been redrafted so that certain of the provisions are altered in such a way as to perhaps result in crippling State regulation of accounts and depreciation in a very vital way," *Federal Communications Commission: Hearings on H.R. 8301 Before the House Comm. on Interstate and Foreign Commerce*, 73d Cong., 2d Sess. 70 (1934) [hereinafter cited as *House Hearings*]. NARUC's general solicitor stated bluntly, with respect to Section 220(j), that "[t]hat matter is all right in this bill and all wrong in the last draft of the Senate bill" (*House Hearings* 137). He recommended responding to the conflict between subsections (b) and (j) identified by AT&T's president by revising Section 220(b). Specifically, he proposed amending Section 220(b) to provide that carriers were forbidden to use depreciation rates other than those prescribed by the FCC "in the accounts prescribed by the commission" in place of Section 220(b)'s flat prohibition of the use of depreciation rates other than those prescribed by the FCC (*id.* at 144). The bill passed the House without significant modification of Section 220.

The Conference Committee essentially adopted the Senate's version of Section 220(j).[28] Contrary to

[28] As signed by the President, Section 220(j) provided:

(j) The Commission shall investigate and report to Congress as to the need for legislation to define further or harmonize the powers of the Commission and of State

NARUC's suggestion, Section 220(b) was not changed. Thus, Congress clearly intended that the FCC would prescribe uniform depreciation rates, and, after it did, that telephone companies would not use any other depreciation rates, as Section 220(b) plainly states.[29]

3. The resulting structure of Section 220 further supports the conclusion that Congress intended the FCC to have authority to prescribe preemptive depreciation methods and rates. Congress responded

commissions with respect to matters to which this section relates.

A comparison of this version of Section 220(j) with the version as introduced (see note 26, *supra*) and the version as revised by the Senate (see note 27, *supra*) clearly refutes California's contention (Br. 23-24) that Section 220(j) is a compromise provision that does not assume that the FCC has authority to preempt. Section 220(j) as enacted is a condensed version of the Senate's revision.

[29] Subsequent legislative history supports the FCC's *Preemption Order* as well. First, as we explain (page 36-37, *infra*), Congress in 1971 enacted Section 410(c), which generally provides for FCC control over matters affecting interstate and intrastate communications while providing for consultation with state representatives. Second, Congress considered a bill that would have overturned the *Preemption Order* in 1983. H.R. Rep. 98-479, 98th Cong., 1st Sess. 53 (1983). Congress did not enact that bill. Moreover, while the bill would have given state commissions authority to prescribe depreciation methods and rates (see H.R. 4102, 98th Cong., 1st Sess. § 7 (1983)), it would also have placed constraints on the state commissions. Congress recognized that "in an effort to keep local rates low" state commissions had preferred depreciation methods that are not designed to encourage modernization of plant. H.R. Rep. 98-479, *supra*, at 53. Accordingly, the bill considered by Congress would have required state commissions to use the remaining life method (*id.* at 54).

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Nos. 84-871, 84-889, 84-1054, and 84-1069

In The

Supreme Court of the United States

October Term, 1984

Louisiana Public Service Commission, Appellant

v.

Federal Communications Commission and United States of America

California and Public Utilities Commission of California, et al., Petitioners

v.

Federal Communications Commission and United States of America

Public Utilities Commission of Ohio, et al., Petitioners

v.

Federal Communications Commission and United States of America

Florida Public Service Commission, Petitioner

v.

Federal Communications Commission and United States of America

On Appeal And On Petitions For A Writ Of Certiorari To The United States Court Of Appeals For The Fourth Circuit

REPLY BRIEF OF APPELLANT, THE LOUISIANA PUBLIC SERVICE COMMISSION, AND PETITIONERS, THE PUBLIC UTILITIES COMMISSION OF OHIO AND THE OHIO OFFICE OF CONSUMERS' COUNSEL

[Counsel listed on inside front cover]

COCKLE LAW BRIEF PRINTING CO., (800) 835-7427 Ext. 333

28 PP

Anthony J. Celebreeze, Jr.
Attorney General of Ohio
Robert S. Tongren
Assistant Attorney General
Counsel of Record
Mary R. Brandt
Assistant Attorney General
Office of the Ohio
Attorney General
Public Utilities Section
180 East Broad Street
Columbus, Ohio 43215
Telephone: (614) 466-4395

Attorneys for the Public
Utilities Commission of Ohio

William A. Spratley
Consumers' Counsel
Richard P. Rosenberry
Lawrence F. Barth
Associate Consumers' Counsel
137 East State Street
Columbus, Ohio 43215
Telephone: (614) 466-9539

Attorneys for the Ohio Office
of Consumers' Counsel

Michael R. Fontham
Counsel of Record
Paul L. Zimmering
Noel J. Darce
Of STONE, PIGMAN,
WALTHER, WITTMANN
& HUTCHINSON
546 Carondelet Street
New Orleans, Louisiana 70130
Telephone: (504) 581-3200

Marshall B. Brinkley
General Counsel
Louisiana Public Service
Commission
Suite 1630
One American Place
Baton Rouge, Louisiana 70825
Telephone: (504) 342-4429

Attorneys for the Louisiana
Public Service Commission

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This reply brief is submitted on behalf of the appellant and petitioners in Nos. 84-871 and 84-1054[1] to address the arguments of the FCC and United States (collectively, "the Government"), AT&T, the Bell companies and other telephone companies (collectively, "telephone companies"), and GTE Service Corp. ("GTE"), appellees-respondents (collectively, "respondents").

ARGUMENT

Four major contentions of the respondents require responses. First, the Government and the telephone companies attempt to belittle the argument that Section 220 is a reporting provision and not binding for ratemaking, but offer no meaningful response. Second, the respondents present a fallacious picture of the language and legislative history of the Communications Act. They assert that the compromise over Section 220(j)—which was originally designed to give the States plenary authority over accounting—had the effect of eliminating virtually all State ratemaking perogatives.

Third, the respondents assert that Congress meant to give the States virtually no ratemaking authority in the Communications Act. They contend that the States can regulate "purely intrastate" plant, but simultaneously argue that there is no such plant. Alternatively, they say that Congress gave the States authority only over rate design and other minor matters—a revolutionary interpretation of the Act. Fourth, the respondents raise a flurry of warnings that the telephone companies, which already were among the richest and strongest companies in the nation when the *Preemption Decision* was issued, would not be willing or able to modernize without accelerated

[1] Because of the time limitation, this brief could not be consolidated with a draft being prepared by the Florida Public Service Commission, although we support the positions asserted therein. This brief employs the same abbreviations of legislative history citations as were used in our first brief.

capital recovery. These arguments do not justify the *Preemption Decision.*

1. The Government and telephone companies have no substantive answer to the point that accounting practices, including depreciation, have never been deemed binding for ratemaking, so they react with scorn. The Government labels our argument "frivolous." (Br. 34). The telephone companies deride our authorities as "scraps," purportedly presented in a "jumble[d]" fashion, and contend that we cite only one on-point depreciation case. No party offers any authority, nor any sound argument, showing that FCC accounting or depreciation prescriptions do bind State ratemakers. Indeed, in their footnotes the Government and the telephone companies *concede* that State ratemakers are not bound by FCC accounting practices, but attempt to distinguish depreciation from accounting. (Gov. br. 34 n.32; Telcos. br. 20 n.54). GTE also attempts to draw this distinction. (GTE br. 13). No valid reason exists to adopt this argument, which would overrule the existing law and tie the hands of regulators in a manner that Congress did not intend.

The Government concedes that the "uniform accounting system . . . often does not govern ratemaking" and that a claimed expense may be disallowed "in part or in whole because it is excessive or unreasonable, or . . . contrary to sound ratemaking policy." (Br. 34 n.32). It employs artful language in distinguishing depreciation, saying that accounting does not bind ratemaking, but depreciation "clearly is binding *on carriers* for ratemaking." (*Id., emphasis supplied*) The telephone companies indicate in text that the State ratemakers are bound by *all* FCC accounts, but concede in a footnote that properly classified expenses may be disallowed by ratemakers. (Br. 13, 20 n.54). Like the Government, the telephone companies and GTE attempt to distinguish depreciation from accounting (Telcos. br. 21; GTE br. 13).

The concession that accounting does not bind ratemaking establishes that Section 220 does not prohibit separate intrastate records. If ratemaking adjustments are made to the books of a carrier, separate records are necessary to ensure a consistent basis for ratemaking in the future, as the FCC recognized in its initial preemption decision. *Amend. of Part 31,* 89 F.C.C.2d 1094, 1098 (1982), J.S. App. at A-67. Thus, the concession encompasses ratemaking *and* recordkeeping.

None of the appellees provides authority for the claimed distinction between accounting and depreciation. They urge the Court to create this exception because a) Congress assertedly paid a lot of attention to the depreciation provisions in 1934, indicating Congress "understood" these provisions governed rates; b) depreciation accounting purportedly played the "central role" in the economic regulation of carriers when Congress enacted Section 220(b); c) accounting prescriptions supposedly are more "general" than depreciation prescriptions; and d) we assertedly cite insufficient authority—"exactly *one* reported case"—approving a State deviation from an FCC depreciation practice. (Gov. br. 34; Telcos. br. 20; GTE br. 13; Telcos. br. 21). These arguments are meritless.

First, contrary to the claims of the respondents, the distinction between depreciation accounting and ratemaking was well established in 1934. Respondents forget that the computation of rate base *and* depreciation for ratemaking was based on *fair value* pursuant to the decisions of this Court; the computation of rate base and depreciation under the ICC uniform system of accounts was based on original cost. This Court had repeatedly rejected the theory that original cost methods should determine economic regulation. Thus, Congress could not have believed that FCC depreciation prescriptions would bind ratemakers any more than other FCC accounting practices.

At the time the Act was passed, this Court required regulators to base ratemaking decisions on the "fair value" of the plant of a utility. *State of Missouri ex rel.*

Southwestern Bell Tel. Co. v. Public Serv. Com'n, 262 U.S. 276, 287 (1923); *Minnesota Rate Cases,* 230 U.S. 352, 454 (1913). The fair value approach gave great weight to the replacement cost of plant, which could be higher or lower than original cost less depreciation. The Court also mandated that the depreciation allowed as an expense be based on present value, or replacement cost, rather than original cost. Thus, in *United Rys. & Elec. Co. v. West,* 280 U.S. 234 (1930), the Court overruled a rate order of a state commission that made a depreciation allowance based on original cost. It stated: "The allowance for annual depreciation made by the Commission was based upon cost. The Court of Appeals held that this was erroneous and that it should have been based upon present value. The court's view of the matter was plainly right . . . ." *Id.* at 253.

In 1931, in *Depreciation Charges of Tel. Cos.,* 177 I.C.C. 351 (1931), an ICC depreciation case that the telephone companies and GTE claim preempted state ratemaking, the ICC considered whether the federal accounting rule should be consistent with the Court's ratemaking rule. The ICC recognized that the Court's decision was inconsistent with ICC accounting practices. *Id.* at 373-74. Nevertheless, the ICC reaffirmed the original cost depreciation approach on the theory that it was merely performing an "administrative function." *Id.* at 380. It said: "It is not essential that the accounts should correspond in all respects with the facts which may be controlling in a confiscation case." *Id.* at 381. Since the original cost depreciation method was an accounting practice and not a ratemaking rule, the ICC concluded that it "does not contravene decisions of the Supreme Court." *Id.* at 382.

In April, 1934, *while the Communications Act was under consideration in Congress,* the Court decided *Lindheimer v. Illinois Bell Tel. Co.,* 292 U.S. 151 (1934). In that case, the Illinois Commission disallowed part of the

booked depreciation expense of the company. The Court noted that "the company has used the 'straight line' method of computation, a method approved by the Interstate Commerce Commission." *Id.* at 167-68. Nevertheless, the Court affirmed the decision of the state agency, ruling that the company had not proven the need for the allowance reflected on its books. It stated:

> Confiscation being the issue, the company has the burden of making a convincing showing that the amounts it has charged to operating expenses for depreciation have not been excessive. That burden is not sustained by proof that its general accounting system has been correct. [Calculating depreciation] involves the examination of many variable elements and opportunities for excessive allowances, even under a correct system of accounting, are always present. *Id.* at 169-70.

Given the inconsistency between "original cost" accounting and the "fair value" ratemaking principle established by the Court, along with the explicit holding that the Illinois Commission properly deviated from the depreciation practice prescribed by the ICC, Congress could not have believed that the FCC depreciation authority taken from the Interstate Commerce Act would bind intrastate ratemakers. The non-binding nature of depreciation prescriptions was explicitly determined. The FCC undoubtedly recognized this fact after its creation, because it assured the Court in *American Tel. & Tel. Co. v. United States,* 299 U.S. 232, 240-42 (1936), a case involving the computation of *investment* and *depreciation,* that accounting practices would not necessarily determine ratemaking treatment. The telephone companies concede this construction of *AT&T,* but imply that it involved expense issues other than depreciation. (Br. 20 n.54).

Second, it is not true that Congress paid undue attention to the depreciation issue. Section 220 received scant attention in the House and Senate reports, took up

relatively little time in committee hearings, and got virtually no attention in floor debates. The ICC comments devote one short paragraph, of more than 120, to Section 220(j), and did *not* oppose the provision. The members of Congress were much more interested in controlling monopoly power, keeping rates low, and preserving state jurisdiction than they were in accounting. H.R. Rep. at 7; S. Rep. at 5; S. Hearings at 94-97, 180-84, 205; H.R. Hearings at 96, 137-44, 185-91, 243, 246, 249; 78 Cong. Rec. 8822 *et seq.*, 10312 *et seq.* (1934), H.R. Hearings 165-202; 78 Cong. Rec. 8823 (1934).

Third, there is no basis for distinguishing depreciation on the ground that other accounting prescriptions are "general." In 1934, this Court ruled in *Lindheimer* that depreciation accounting was too inexact to bind ratemakers individual cases. Moreover, the ICC had ruled, in a case cited by the respondents, that "uniform rates of depreciation cannot be established for all telephone companies," and had delegated the task of determining individual company rates to the State commissions. *Depreciation Charges of Tel. Cos.*, 118 I.C.C. 295, 332 (1926). Since the ICC deemed itself incapable, as a practical matter, of prescribing accurate depreciation rates for individual companies, Congress could not have assumed that FCC prescriptions would be more exact than other accounting entries.

Fourth, the telephone companies reveal a stark inconsistency when they sarcastically assert that we found "exactly *one* reported case" on depreciation. (Br. 21). On the one hand, they repeatedly assure the Court that the FCC decision on expensing versus capitalization of station connections is, truly, a "depreciation" decision. (Br. 1, 6, 7 n.18, 9, 35). On the other hand, they claim that our authorities on expensing versus capitalization of research and development costs, and interest during construction, are not "depreciation" decisions. This inconsistency is

not indicative of a logical position. In any event, in addition to the Court's decisions, other authorities establish that FCC depreciation practices are not binding for intrastate ratemaking. *Re New York Tel. Co.*, 20 PUR3d 129, 143 (N.Y.P.S.C. 1957) (Commission can deviate from FCC depreciation prescriptions "for the purpose of determining what are fair charges to operating expenses"); *Re New England Tel. & Tel. Co.*, 35 PUR3d 100, 105 (Vt. P.S.C. 1960) (FCC depreciation order disregarded for intrastate ratemaking). Indeed, the FCC itself issued an administrative statement in 1980 that its depreciation prescriptions did not bind the New York Commission for ratemaking. (App. A).

Fifth, the Government makes a drastic turnabout in calling our argument "frivolous." In its first decision on the preemption issue, the FCC pointedly referred to the limited function of *all* accounting rules, holding that these rules do not preclude ratemaking adjustments. *Amend. of Part 31,* 89 F.C.C.2d 1094, 1099 (1982), J.S. App. at A-67-A-68, A-70). It cited *Interstate Comm. Com'n v. Goodrich Trans. Co.*, 224 U.S. 194 (1912), where the Court stated that the ICC needed *information* to accomplish its regulatory task. The Court added:

> The object of requiring such accounts to be kept in a uniform way . . . is not to enable [the ICC] to regulate the affairs of the corporations not within its jurisdiction, but to be informed concerning the business methods of the corporations subject to the act that it may properly regulate such matters as are really within its jurisdiction. *Id.* at 211.

The FCC concluded that construing Section 20 to limit state rate regulation "would have been inconsistent with the Court's description of the nature and function of the accounting rules." 89 F.C.C.2d at 1099, J.S. App. at A-69-

A-70. The FCC did not distinguish depreciation and other accounting, since the purported distinction was unheard of when its first decision on preemption was issued.

If the respondents really believe in their depreciation distinction, they are disingenuous in failing to deal with the fact that the *Expensing Order* makes an expense classification rather than a depreciation prescription. The respondents concede that expense classifications may be disallowed. Moreover, *every* expense classification embodies the implicit finding that the cost should not be capitalized and depreciated. In addition, the respondents' insistent reliance on Sections 220(h) and (i) is misplaced, since these provisions deal generally with accounts and do not mention depreciation.

Finally, the telephone companies attack our position by mischaracterizing it. We do not contend, as they say, that accounting and depreciation prescriptions are "irrelevant" to ratemaking. (Telcos br. 19). Books of account today serve as a relevant and useful *starting point,* but the figures may and should be adjusted when the evidence, or regulatory principle, requires. The respondents' argument would preclude these adjustments.

In order to uphold the *Preemption Decision*, the Court must not only prohibit intrastate recordkeeping, but overturn the universal rule that accounting precepts do not bind ratemakers. To support this action, the respondents argue that ratemakers have always been bound by Section 220(b). This argument is contrary to law, history and reason. When carried to its logical conclusion, the respondents' proposed rule would destroy virtually all state regulatory control over the revenues of utility companies. No basis exists to determine that Congress intended this result.

2. The respondents present a narrow, unrealistic picture of the statute and its legislative history in arguing

that Congress intended the FCC to raise intrastate rates through its accounting prescriptions. They argue that Section 220(b) is mandatory and exclusive — prohibiting carriers from keeping any supplemental records for any purpose without a specific authorization from the FCC. They assert that Section 220 is more specific than Section 2(b), and therefore controls it, and they brush aside or ignore other provisions protecting State jurisdiction. The respondents inaccurately portray the legislative history, contending that a compromise over Section 220(j) was actually a prescription for FCC regulation of intrastate rates. (Gov. br. 16, 24, 33, 27-31; Telcos. br. 13, 31, 15-19; GTE br. 12-13, 30, 13-24). These contentions are invalid.

The argument that Section 220(b) is mandatory — prohibiting carriers from maintaining any depreciation records for any purpose without an FCC authorization — is erroneous. Section 220(b) is no more mandatory than Sections 220(a) and (g), which, read expansively, would make it unlawful to keep any "accounts, records or memoranda" other than those prescribed or approved by the FCC. This sweeping construction is inconsistent with the rulings of this Court and the longstanding practice of carriers to keep many other records and accounts — including depreciation records — for other purposes.

Prior to the enactment of Section 220, this Court construed its model, Section 20 of the Interstate Commerce Act, as having a limited reach. The Court held that the accounting provisions were *not* designed to enable the ICC to regulate matters outside its jurisdiction, but to obtain information to "properly regulate such matters as are really within its jurisdiction." *Interstate Comm. Com'n v. Goodrich Trans. Co.,* 224 U.S. 194, 211 (1912). This limited construction was reaffirmed by the Court after Section 220 was passed. *American Tel & Tel. Co. v. United States,*

299 U.S. 232, 237 (1936). The limitation of Section 220, reflecting the implicit limitation contemplated by Congress, establishes that the provisions are mandatory only for interstate reporting purposes.

Moreover, the construction of the respondents would lead to absurd results. Carriers frequently maintain records that are not explicitly authorized by the FCC. The respondents' interpretation would preclude records or memoranda respecting personnel, civil rights, administration and other subjects. As the FCC itself observed in its first preemption ruling, their construction would "preclude carriers from using accelerated depreciation methods for purposes of computing their income taxes since such methods differ from the depreciation methods that have been prescribed for ratemaking purposes," and "restrict other forms of state or federal regulation that might require [different] accounting records or information. . . ." *Amend. of Part 31,* 89 F.C.C.2d 1094, 1100 (1982), J.S. App. at A-70. The FCC noted that a similar interpretation of the Interstate Commerce Act had been "summarily rejected" by a federal appeals court. *Id.,* citing *Kansas City So. Ry. Co. v. Commissioner of Int. Rev.,* 52 F.2d 372 (8th Cir. 1931).

The statutory interpretation of the respondents is also flawed. Their "specificity" argument actually reflects a major weakness: Section 220 is more *limited* than other sections because it deals only with accounting. Section 2(b) is very specific; it protects state jurisdiction over *charges,* the *classifications* and *practices* affecting charges, and *services, facilities* and *regulations.* Moreover, by providing that "nothing in this chapter" shall interfere with intrastate regulation, Section 2(b) limits the scope of Section 220 and every other provision in the Act. Indeed, Congress deemed it necessary to write exceptions into Section

2(b) for Sections 301 and 224, relating to radio and pole attachments; no exception exists for Section 220. In addition, Section 2(b) exempts "connecting" carriers from the requirements of Section 220 even if they carry interstate calls. Since these carriers have not been subjected to FCC reporting requirements, Section 2(b) *must* control over Section 220.

The respondents essentially ignore the provision in Section 3(e) that excludes *any* communication already regulated by a state commission, even if it crosses state lines, from the definition of "interstate communication." GTE makes an incongruous argument concerning Section 221(b), which contains a similar exclusion. It contrasts this section with Section 2(b), saying that Congress "knew how" to exclude FCC authority over jointly used plant regulated by the States because *it did so* in Section 221(b). (GTE br. 10). Given that concession, GTE does not explain how it hopes to prevail in this case.

Perhaps GTE implicitly relies on the interpretation of the telephone companies — that Section 221(b) applies to exchanges straddling state lines. (Telcos. br. 31 n.84). Yet this contention is also incongruous: Congress could not have intended to give the States less authority over jointly used plant *within* States than over jointly used plant in exchanges straddling State lines. Even if this contention were accepted, the application of the *Preemption Decision* to interstate metropolitan exchanges — such as the huge exchange covering Washington, D.C. and parts of Maryland and Virginia — would conflict with the *conceded* meaning of Section 221(b).

In their legislative history argument, the respondents misportray the context in which the Act was passed and misinterpret the compromise over Section 220(j). The telephone companies and GTE assert that the ICC had claimed exclusive power over accounting and depreciation

when the Act was passed. (Telcos. br. 16; GTE br. 15-16). But the ICC held only that it could prescribe depreciation practices and require the reporting of company-wide data; it did not hold that the States could not require their own depreciation reports. *Depreciation Charges*, 118 I.C.C. 295, 332 (1926). Indeed, the ICC specifically recognized that the States could prescribe depreciation rates; it had previously left two of its own accounts open "for use in the event that any of the state commissions prescribed depreciation accounting." *Id.* at 374. In its first decision on preemption, the FCC rejected the reading of the ICC decisions proferred by the telephone companies and GTE. *Amend. of Part 31*, 89 F.C.C.2d 1094, 1100-01 (1982), J.S. App. at A-71-A-72. Moreover, this Court in April, 1934 rejected the ICC depreciation practice for intrastate ratemaking in *Lindheimer v. Illinois Bell.*

In 1934, the ICC did *not* regulate telephone rates. The Senate report described ICC regulation of the telephone monopoly as "practically nil." S. Rep. at 2. The ICC had been unable to prescribe specific depreciation rates for telephone companies and asked the State commissions to make the prescriptions for it. *Depreciation Charges*, 118 I.C.C. 295, 374 (1926). State regulation applied to about 99 per cent of telephone communications. H.R. Hearings at 132. State representatives participated in drafting the Communications Act, inserting provisions much different from those in the Interstate Commerce Act, designed to preserve *all* existing State regulatory authority. 78 Cong. Rec. 8823; 47 U.S.C. §§ 152(b), 153(e), 221(b). The reservations included a provision protecting the right of State agencies to *value* the property of carriers, which necessarily involves depreciation. 47 U.S.C. § 213(h). These provisions were not changed or deleted.

The relatively minor dispute over Section 220(j) reflected an attempt by the States to eliminate any *possibility* of FCC intrusion into intrastate regulation. The

general solicitor of NARUC expressed the fear that, without the provision, an FCC prescription order "might be pointed to by the utilities" as binding the States. H.R. Hearings at 137. He asserted that this *potential argument* would be illogical, referring to *Lindheimer* and the ICC ruling that depreciation rates could only be prescribed on a case-by-case basis. *Id.* at 138-39. He asked for no particular language, not even the proposed language in Section 220(j), but some language to "make it clear" State powers were unhampered. *Id.* at 143.

No party opposing the original Section 220(j) ever suggested that changing the provision would curb State ratemaking prerogatives. The AT&T president objected to the provision because, in his view, it would require different accounts for different jurisdictions, precluding consolidated reporting by utilities on a uniform basis. H.R. Hearings at 191. The ICC agreed that the provision was inconsistent with uniform accounting. *Id.* at 96. These parties were concerned with preserving a primary system for reporting the affairs of carriers.

The compromise over Section 220(j) removed the House provision turning over primary accounting jurisdiction to the States, but it also eliminated the implication in the Senate version that legislation would be necessary to permit the States to prescribe accounting practices. S. 3285, 73d Cong. 2d Sess., § 220(j) (1934). Contrary to the respondents' claims, the final version is vastly different from the Senate version; it refers evenhandedly to harmonizing "the powers of the commission and of State Commissions" concerning accounting matters. 47 U.S.C. § 220(j). Moreover, Section 410(b) allows the FCC to "confer" with State commissions concerning "the relationship between [FCC and State] . . . accounts. . . ." This history and language cannot support a conclusion that Congress meant to preclude carriers from keeping any intrastate records.

In addition, Congress was aware of this Court's decision in *Smith v. Illinois Bell Tel. Co.*, 282 U.S. 133 (1930), requiring jurisdictional separations. In providing that the FCC could classify property to "be considered" as interstate, Congress prescribed the limit of FCC ratemaking jurisdiction. Like *Smith*, Section 221(c) openly contemplates the division of investment and costs for the same pieces of equipment. This provision destroys the argument that State and Federal depreciation rates on the equipment have to be the same. Similarly, when Congress passed the Federal-State Joint Board Act in 1971, it knew that the separations process would determine the limits of the respective ratemaking jurisdictions. *See* 47 U.S.C. § 410(c). The process was explained in the House as follows: "[T]he same plant, equipment, and expenses are in most instances involved in providing both intrastate and interstate telephone service. Hence plant and equipment are 'separated,' to use the jargon of the industry, for purposes of ratemaking." 117 Cong. Rec. 28906. The separations process accommodates differences in Federal and State ratemaking policies and makes prior court of appeals decisions — which approved preemption when irreconcilable conflicts existed — inapplicable here.

Finally, the Government contends that the FCC previously had "no occasion" to rule on the preemptive effect of its depreciation prescriptions and "there had been no direct challenges to the FCC's prescription orders." (Br. 25). This statement is inaccurate. One pointed example occurred in New York in 1980, when the telephone company claimed that FCC depreciation prescriptions were binding for ratemaking. This interpretation was brought to the attention of the FCC. Its Secretary responded:

> Please note that the rates that we prescribed must be used by NYTC for its financial reporting; however, decisions as to the ratemaking treatment of the expenses measured by application of these rates are matters more appropropately [sic] addressed by the agency having specific jurisdiction. (App. A).

Moreover, the claims of the Government are generally inconsistent with the description of past practice by the FCC in its initial preemption ruling. *Amend. of Part 31,* 89 F.C.C.2d 1094, 1107 (1982), J.S. App. at A-82-A-83.

Section 220 provides a means to ensure that carriers report company-wide data on a uniform basis. It was not meant to hinder state ratemaking or preclude intrastate recordkeeping. This section does not justify the *Preemption Decision.*

3. Approval of the *Preemption Decision* would eviscerate virtually all State ratemaking authority. The logical consequence of the respondents' arguments is to reduce intrastate ratemaking to a formalistic acceptance of FCC-prescribed accounting data. The potential breadth of the FCC intrusion is demonstrated when the respondents claim that "purely" intrastate facilities are protected under Section 2(b), but simultaneously contend that there is no such thing. (GTE br. 24, 24-25; Telcos. br. 3, 2; Gov. br. 35, 3). By asserting that the States may preside over "rate design," the respondents implicitly contend that all but the final step in the ratemaking process may be taken away. (Gov. br. 40; Telcos. br. 34 n.94). This result was never intended by Congress.

The respondents concede that the States retain control over "purely intrastate" facilities, although they also assert that virtually all telephone plant is jointly used. Their concession establishes that Section 220 does not bind ratemakers for all plant reported on the FCC uniform accounts; if Section 220 concededly does not reach "purely" intrastate plant for ratemaking, then it is just as reasonable to conclude it reaches no plant allocated to the intrastate jurisdictions. In addition, although purely intrastate

plant is proportionately small, it is significant in dollar terms. In Louisiana in 1984, rates were fixed at more than $40 million for intrastate private line services, enough to cover the cost of more than $100 million in investment. *Re South Cent. Bell Tel. Co.*, Docket No. U-15955 (La. P.S.C. 1984). Michigan Bell in 1981 reported $321 million in intrastate private line investment. Ex. A-12, *Re Michigan Bell Tel. Co.*, Docket No. U-7473 (Mich. P.S.C. 1982). The respondents' concessions establish that the *Preemption Decision* was applied illegally to these facilities.

In any event, the respondents' argument would eviscerate all, or nearly all, State ratemaking jurisdiction. The States would be reduced to checking the mathematical accuracy of the revenue requirement claimed by the utility based on its books of account. The respondents try to deflect this point by claiming this is only a "depreciation" case, but the *Preemption Decision* also requires State regulators to expense 100 per cent of the affected station connection costs in the year incurred. Moreover, the accounting provisions of Section 220 are very similar to Section 220(b) and the respondents rely heavily on two of them — Sections 220(h) and (i). (Gov. br. 6; Telcos. br. 10-11, 13-14). Furthermore, the "joint use" theory applies as much to any accounting decision as it does to depreciation. Thus, if the *Preemption Decision* is approved, all FCC accounting rulings could become ratemaking decisions for the States.

The respondents concede this ramification when they proclaim that "rate design" is the only prerogative of the States. The telephone companies argue for this result, stating that Section 2(b) only preserves the right of State agencies to allocate a predetermined revenue requirement among different types of customers. (Br. 33). This contention is based on the reasoning that the reservation of State authority over "charges, classifications, practices, services, facilities, or regulations" in Section 2(b) is

equivalent to the FCC jurisdiction over "charges, classifications [and] practices" in Sections 201-05. The telephone companies interpret the FCC authority as limited to spreading the revenue requirement among different customers — *not* to adjust the per books requirement to avoid unfairness to consumers as a group. Incredibly, the Government appears to accept this theory, perhaps unwittingly. (Br. 39 n.35).

The rate design assertion is erroneous. Section 202 defines "charges" as "charges for . . . the use of common carrier lines of communication," or rates. Section 203(a) refers to "classifications, practices and regulations *affecting* such charges." *(Emphasis supplied)*. The respondents concede that the depreciation and accounting classifications and practices affect rates. (Gov. br. 39; Telcos, br. 34). Therefore, Congress intended to give both the FCC and the States full ratemaking discretion in their respective spheres. In addition, it would be erroneous to conclude that Congress in 1934 wanted to curb, rather than enhance, regulatory power over monopolies.

Congress preserved more for the States than the right to regulate nonexistent plant or preside only over the final step in the ratemaking process. The arguments of the respondents are meritless.

4. The respondents virtually abandon the original FCC justification for preemption — to promote so-called "competition" in the marketplace. *Preemption Decision*, 92 F.C.C.2d 864, 877 (1983). The idea of raising rates for monopoly service to promote competition is too ludicrous to withstand the test of time. Instead, the respondents now assert that there are grave dangers and perils from State-prescribed depreciation that will discourage new investment to modernize the telephone network. (Gov. br. 12-13; Telcos. br. 24-26). This argument might make

sense in another context, but not as it applies to the telephone industry.

The companies covered by the *Preemption Decision* — the nation's largest telephone companies — are rolling in internally-generated cash. The FCC observed that in 1982 AT&T financed virtually 100 per cent of its construction program through internal generation of funds— before the *Preemption Decision. Prescription of Revised Percentages of Depreciation,* 96 F.C.C.2d 257, 265 (1983). Moody's reports that the Bell System in 1982 generated $16.2 billion internally and had a $16.5 billion construction program. (1984 Moody's Pub. Util. Man. 186). The electric industry, by comparison, generated only about $4.6 billion internally of $10.8 billion in construction requirements. (1985 Moody's Pub. Util. Man. a13). Moreover, the securities of the affected telephone companies are considered low in risk and rated relatively high compared to the securities of other utilities. *(See* 1985 Moody's Pub. Util. Man. a100 *et seq.*). The picture of impending doom is absurd.

In addition, the telephone companies make it very clear that their financial condition must *exceed* constitutional and statutory standards to meet their perceived needs. (Br. 27). In other words, the standards announced by this Court for ensuring fairness to investors, as well as consumers, *are not enough. See Federal Pow. Com'n v. Hope Nat. Gas Co.,* 320 U.S. 591 (1944). The carriers say they will modernize when the asserted "risk of unduly delayed cost recovery is overcome." (Br. 27). Even this assurance, however, means little; for instance, the construction program of the BellSouth companies, as a percentage of net plant, went *down* in 1983 and went *down* again in 1984, after the *Preemption Decision. (See* 1983 Moody's Pub. Util. Man. 233, 239; 1985 Ann. Rep., BellSouth Corp.) The telephone companies criticize the State

commissions for a "bland assurance" of fair rates, but their bland promise to modernize is not subject to court review. (Br. 27).

In its rush to hand cash to the telephone companies at the expense of intrastate ratepayers, the FCC did not pause to demonstrate any need for faster cash flow. If the inadequacy of intrastate depreciation could be demonstrated by evidence, the telephone companies could expect relief in State commissions and courts. But the FCC and telephone companies do not seek fairness under accepted standards; they seek a more-than-fair result by fiat.

Even if the reasoning of the FCC had credibility, which it does not, its decision still exceeds boundaries established by Congress. Therefore, the ruling is invalid. *Fidelity Fed. Sav. and Loan Ass'n v. de la Cuesta,* 458 U.S. 141 (1982); *Rice v. Santa Fe Elevator Corp.,* 331 U.S. 247 (1947).[2]

———o———

[2] *Capital Cities Cable, Inc. v. Crisp,* 104 S.Ct. 2694 (1984), cited by the respondents, did not change the preemption analysis and did not involve restrictions placed on the FCC by Congress.

CONCLUSION

The respondents do not justify the *Preemption Decision.* Their arguments are conflicting and illogical and entail unacceptable consequences. They would overturn the regulatory principle that accounting does not bind ratemaking, jettison the "separations" dividing line created by this Court and Congress, and eviscerate the ability of state regulators to ensure fairness to consumers. Congress did not, could not, intend this result. The ruling should be reversed.

Respectfully submitted,

Anthony J. Celebreeze, Jr.
Attorney General of Ohio
Robert S. Tongren
Assistant Attorney General
Counsel of Record
Mary R. Brandt
Assistant Attorney General
Office of the Ohio
Attorney General
Public Utilities Section
180 East Broad Street
Columbus, Ohio 43215
Telephone: (614) 466-4395

Attorneys for the Public
Utilities Commission of Ohio

William A. Spratley
Consumers' Counsel
Richard P. Rosenberry
Lawrence F. Barth
Associate Consumers' Counsel
137 East State Street
Columbus, Ohio 43215
Telephone: (614) 466-9539

Attorneys for the Ohio Office
of Consumers' Counsel

Michael R. Fontham
Counsel of Record
Paul L. Zimmering
Noel J. Darce
Of STONE, PIGMAN,
WALTHER, WITTMANN
& HUTCHINSON
546 Carondelet Street
New Orleans, Louisiana 70130
Telephone: (504) 581-3200
Marshall B. Brinkley
General Counsel
Louisiana Public Service
Commission
Suite 1630
One American Place
Baton Rouge, Louisiana 70825
Telephone: (504) 342-4429

Attorneys for the Louisiana
Public Service Commission

APPENDIX A

FEDERAL COMMUNICATIONS COMMISSION

Washington, D.C. 20554

November 25, 1980

In Reply Refer To:
61730

Mr. Samuel R. Madison, Secretary
New York Public Service Commission
Empire State Plaza
Albany, New York 12223

Received
December 3, 1980
Communications
Division
Albany

Dear Mr. Madison:

The Commission, by its Order of November 6, 1980 prescribed revised depreciation rates for the plant of New York Telephone Company (NYTC).

A copy of the Order, together with the new schedule of annual percentages of depreciation, is enclosed for your information.

The following is with regard to your letters dated April 15, 1980 and May 2, 1980 to Mr. Philip L. Verveer, Chief of our Common Carrier Bureau. The FCC representatives who attended the March, 1980 depreciation meetings acknowledge that your Communications Division's staff did raise strong objections to the proposed rates for Station Apparatus-Teletypewriter and Station Apparatus-Telephone and Miscellaneous. Furthermore, your staff did indicate that they would likely challenge the use of those rates for intrastate ratemaking. Please note that the rates that we prescribed must be used by NYTC for its financial reporting; however, decisions as to the ratemaking treatment of the expenses measured by application of those rates are matters more appropriately addressed by the agency having specific jurisdiction.

Sincerely yours,

/s/ William J. Tricarico
Secretary

Enclosure

(23) (23) (21) (21)

Nos. 84-871, 84-889, 84-1054, and 84-1069

IN THE

Supreme Court of the United States

OCTOBER TERM, 1985

LOUISIANA PUBLIC SERVICE COMMISSION,
Appellant

vs.

FEDERAL COMMUNICATIONS COMMISSION AND UNITED STATES OF AMERICA

CALIFORNIA AND PUBLIC UTILITIES COMMISSION OF CALIFORNIA, *et al.*,
Petitioners

vs.

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PUBLIC UTILITIES COMMISSION OF OHIO, *et al.*,
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vs.

FEDERAL COMMUNICATIONS COMMISSION AND UNITED STATES OF AMERICA

FLORIDA PUBLIC SERVICE COMMISSION,
Petitioner

vs.

FEDERAL COMMUNICATIONS COMMISSION AND UNITED STATES OF AMERICA

On Appeal and On Writs of Certiorari to the United States Court of Appeals for the Fourth Circuit

REPLY BRIEF OF PETITIONER, FLORIDA PUBLIC SERVICE COMMISSION

William S. Bilenky, Esq.
General Counsel
Paul Sexton, Esq.
Association General Counsel
Florida Public Service Commission
101 East Gaines Street
Tallahassee, Florida 32301
Telephone: (904) 488-7464

Attorneys for the
Florida Public Service Commission

CASILLAS PRESS INC - 1717 K ST NW WASHINGTON DC - 223-1220

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STATEMENT OF SUPPORT

Due to the press of time and the logistics of preparing a joint brief, the Florida Public Service Commission was unable to file a joint Reply Brief with the Louisiana Public Service Commission, the Public Utilities Commission of Ohio and the Ohio Office of Consumers' Counsel. The Florida Public Service Commission supports the positions advanced by those parties.

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On Appeal and On Writs of Certiorari to the United States Court of Appeals for the Fourth Circuit

REPLY BRIEF OF PETITIONER, FLORIDA PUBLIC SERVICE COMMISSION

SUMMARY OF ARGUMENT

POINT I

47 U.S.C. §220 does not preempt State depreciation rates for intrastate ratemaking purposes. State law is not preempted by Federal Statute unless the subject matter does not permit State

regulation or the intent of Congress to preempt is unmistakable. Independent State regulation of depreciation for intrastate purposes is clearly feasible. Further, there is no evidence, unmistakable or otherwise, that Congress intended to preempt. Instead, Congress intended that the States have autonomy in determining all elements of intrastate ratemaking policy, including depreciation.

Section 220(b) does not show an intent to bind the States for intrastate ratemaking purposes. The purpose of Section 220 is to reflect the financial condition of carriers so that the FCC may prescribe just and reasonable interstate rates and charges under 47 U.S.C. §§201-205. The FCC's interpretation of Sections 220(b) and 220(h) is incorrect, for it nullifies Section 220(j).

In enacting Section 220, Congress rejected a version of Section 220(j) that would have expressly preempted State depreciation for intrastate ratemaking purposes. It is not necessary for Section 220 to expressly preserve State depreciation authority for ratemaking purposes. That is accomplished elsewhere in the Act. Read as a whole, the Communications Act shows a Congressional intent to preserve in the States all authority over intrastate ratemaking, including the various elements used to establish rates and charges. The relationship between State and Federal ratemaking authority under the Communications Act is radically different from that under the Interstate Commerce Act. The effect of Federal accounting and depreciation authority on State ratemaking authority was changed when ICC accounting and depreciation authority was transferred to the FCC.

The FCC's implementation of Section 220 disproves Congressional intent to preempt. Its long failure to indicate that its depreciation prescriptions might be preemptive and its silence in the face of past State deviations show that it did not believe Section 220 to preempt as a matter of law. The FCC has no authority to change its interpretation of Section 220 at this late date.

POINT II

The FCC lacks authority to preempt State telephone depreciation policy for intrastate ratemaking purposes. The FCC's theory of preemptive authority is consistent with Title III of the Act, which provides for unified FCC regulation of broadcasting; however, it is inconsistent with the Congressional scheme of telephone regulation under Title II of the Act. The Communications Act demonstrates a clear intent that telephone communication be subject to dual regulation. Congress intended that State regulation of intrastate telephone communication be complete and that it be unhindered by possible FCC intervention. The Act does not permit FCC preemption of intrastate telephone regulation simply to advance Federal policy. The FCC may preempt only when State regulation encroaches on FCC authority, such as when a particular subject will not permit dual regulation. The FCC's claim of authority to preempt to avoid frustration of its policies defies the intent of Congress to define the relationship of Federal and State authority over telephone communication within the Act. The FCC's theory allows it to supersede all important State policies governing intrastate communication.

ARGUMENT

I. Section 220 does not preempt State authority over depreciation for ratemaking purposes.

Summary

Contrary to the Respondents' assertion, Section 220 does not preempt as a matter of law.[1] This Court has declared that preemption of State law by Federal statute is not favored absent persuasive reasons — either that the subject matter permits no other conclusion or that Congress has unmistakably so ordained. *Alessi v. Raybestos-Manhattan, Inc.*, 451 U.S. 504, 522

[1]47 U.S.C. §220.

(1981). Independent State authority over depreciation for intrastate purpose is clearly feasible. Further, there is no evidence, unmistakable or otherwise, that Congress intended to preempt depreciation for purposes of State ratemaking. Instead, the scheme of the Communications Act is clear: Congress intended State autonomy in all elements of intrastate ratemaking.

A. Dual regulation of depreciation for ratemaking and accounting purposes is clearly feasible.

There is no question that dual regulation of depreciation, both for accounting and ratemaking purposes, is clearly feasible. The States have independently set depreciation rates for intrastate ratemaking purposes for well over 50 years. The FCC didn't actively prescribe depreciation rates until the 1940's. After the FCC began to prescribe depreciation rates, the States continued their prior practices. Though State and FCC depreciation rates were quite often the same, they have differed over the years. Even the lower court acknowledged that carriers could record different depreciation rates. None of the Respondents have demonstrated the practical impossibility of dual regulation of depreciation.[2]

B. Section 220, on its face, reflects no intent to preempt the States.

The Respondents' interpretation of Section 220(b) is not supported by its terms. Nothing in Section 220 purports to effect State authority in any manner and Section 220(b) certainly makes no mention of intrastate ratemaking. The purpose of Section 220(b), like that of Section 20(5) of the Interstate Commerce Act, is simply to require carriers to keep their records in a

[2]Carriers are currently applying dual depreciation rates. For instance, in Florida, General Telephone Company of Florida and Southern Bell Telegraph and Telephone Company apply FCC prescribed depreciation rates for interstate purposes and apply State prescribed depreciation rates for intrastate purposes.

manner that accurately reflects their financial condition so that the FCC may prescribe just and reasonable interstate rates pursuant to Sections 201-205 of the Communications Act.[3]

The Respondents' reading of Section 220 creates discord within the provisions of Section 220. The Respondents' interpretation of subsections (b) and (h) of Section 220 renders subsection (j) a nullity. Under the Respondents' theory, subsection (h) would grant the FCC authority to permit State regulation of intrastate depreciation otherwise precluded by subsection (b). This interpretation of Section 220 would reserve to the FCC the discretion to retain all accounting and depreciation authority to itself or delegate intrastate authority to the States. Thus, under the Respondents' theory, State and Federal authority may be defined and harmonized by administrative action. However, in adopting subsection (j), Congress clearly contemplated that legislation would be necessary for that task. Had Congress intended the scheme proposed by the Respondents, legislation would have clearly been unnecessary and it would not have adopted subsection (j).

C. The legislative history of Section 220 shows that Congress rejected an amendment to Section 220 that would have preempted the States for ratemaking purposes.

Congress considered two versions of Section 220(j). The first was proposed by NARUC and accepted by the House. It provided for independent State authority over accounting in general and over depreciation in particular. The second version was proposed by the Senate. The Senate version clearly prevented the States from prescribing systems of accounts or prescribing depreciation rates for *any* purpose. Congress eventually rejected *both* the House and the Senate versions, opting for uniform accounting without preempting State ratemaking authority.

[3]*See Kansas City So. Ry. v. United States*, 231 U.S. 423, 440 (1913); *Interstate Commerce Commission v. Goodrich Transit Company*, 224 U.S. 194, 211 (1912).

NARUC proposed subsection (j) to ensure that Section 220 could not be interpreted by a court to preclude State commissions from reviewing depreciation rates in rate cases.[4] It was one of many provisions proposed by NARUC to protect State autonomy over intrastate communications. Though a court had yet to rule that ICC depreciation prescriptions under Section 20(5) of the Interstate Commerce Act would preempt the States for intrastate ratemaking, the States sought assurances that Section 220 could not be read to preempt the States.

The States' concern over the interpretation of ICC depreciation authority had existed for years and arose out of a history of Federal domination of intrastate ratemaking under the Interstate Commerce Act. ICC authority to prescribe depreciation rates for accounting purposes, adopted in 1920, became a part of an apparent scheme of Federal domination. When Congress proposed to transfer the ICC's powers to the FCC, the States sought multiple assurances to foreclose even the possibility that the concept of Federal domination could be read into any portion of the Act.

In Section 220, NARUC proposed to establish parallel State authority over depreciation accounting to preclude an interpretation of that Section as preempting State authority over depreciation for ratemaking purposes.[5] AT&T attacked NARUC's

[4]See Hearings on H.R. 8301 before House Committee on Interstate and Foreign Commerce, 73d Cong., 2d Sess. 137, 138 (1934) (House Hearings), statement of John E. Benton.

Subsection (j) was one of three new provisions proposed by NARUC. Subsection (h) was proposed to permit the FCC to exempt small carriers from all Federal reporting, leaving such regulation entirely to the States (See House Hearings at 144; Hearings on S. 2910 before Senate Committee on Interstate Commerce, 73d Cong., 2d Sess. 184 (1934) (Senate Hearings), statement of John E. Benton. Subsection (i) was proposed so that the States could ensure that the FCC's system of accounts served both Federal and State purposes. See House Hearings at 143-144.

[5]NARUC's version of subsection (j), in part, preserved State autonomy to prescribe depreciation rates "for purposes of determining *charges, accounts, records or practices.*"

version of subsections (h) and (j) as destroying the uniformity of systems of accounting.[6] AT&T never asserted that the States should be bound to FCC prescribed depreciation rates for intrastate *ratemaking* purposes. In response to AT&T criticism, the Senate deleted the exemption language from Section 220(h) and proposed an entirely different version of subsection (j) that would have clearly preempted State regulation of depreciation for accounting *and* ratemaking purposes.[7]

When the Senate Bill reached the House, NARUC opposed the Senate's version of subsection (j) because it would have destroyed any State authority over depreciation for ratemaking purposes. In the House Hearings, the Senate's version was described by NARUC as "changed in such a manner as to Shreveport us out of the telephone regulatory field."[8] NARUC emphasized that it did not intend to affect FCC accounting authority.[9]

The House Committee, and the House itself, proposed subsections (h) and (j) in their original form. The Conference Committee, and Congress, adopted the House's version of sub-

[6]See Senate Hearings at 94-97; House Hearings at 189-192.

[7]The Senate's version of subsection (j) required the FCC to report if legislation was desirable to *permit* the States to "prescribe their own percentage rates of depreciation. . . ."

[8]In response to a question as to whether NARUC was more afraid of the House Bill than in favor of it, one of NARUC's representatives stated:

> I would not say that, either. I would be afraid of it, should it be changed in such a manner as to Shreveport us out of telephone regulatory field. In other words, if it substantially ousts us from our jurisdiction; but *we do not apprehend that you are going to change it as the redrafted Dill bill has been changed.* House Hearings at 73.

The only significant difference between the "Dill Bill" (S. 3285) and H.R. 8301 were the provisions of Section 214 and sections 220(h) and (j).

[9]See House Hearings at 138.

section (h) and a totally different version of subsection (j). The final version of subsection (j) did not include language preserving State autonomy over accounting, as provided in the House version. Likewise, it did not include language expressly preempting State depreciation authority for ratemaking purposes, as provided in the Senate version. Instead, it directed the FCC to report on the need for legislation to define or further harmonize Federal and State authority over uniform accounting and depreciation accounting.

Congress' intent in enacting Section 220(j) was to make uniform, as far as reasonably possible, the accounting systems of interstate telephone companies. The House's version was rejected because it could result in multiple sets of books for multistate companies. The Senate's version was rejected because it interfered with State autonomy over intrastate rates, contrary to the scheme of independent State ratemaking authority embodied throughout the Act. Congress intended that carriers operate under a uniform system of accounts but also intended that the States be free to set depreciation rates for intrastate ratemaking purposes.

D. Read as a whole, The Communications Act demonstrates a Congressional intent to preserve State autonomy over all elements of intrastate ratemaking, including depreciation.

An Act is to be read as a whole and each provision must be construed in harmony with other provisions of the Act. *Weinberger v. Hynson, Westcott and Dunning,* 412 U.S. 609, 631-632 (1973). Reading Section 220 in harmony with other provisions of the Communications Act, it is not necessary to amend Section 220 to expressly preserve State depreciation authority for ratemaking purposes. Such an intent is already clearly evident elsewhere in the Act. The relationship of Federal and State authority under the Interstate Commerce Act was radically different from that under the Communications Act of 1934. Given this radical difference, the transfer of Federal accounting and

depreciation authority from the ICC to the FCC necessarily changed the effect of that authority on State regulation.

The Communications Act reflects an intent to safeguard independent State ratemaking authority in all respects. State ratemaking autonomy is emphazied and strengthened throughout the Act. Section 152(b)1 enumerates the elements of intrastate communication reserved to the States.[10] It specifically controls the interpretation of Title II and reserves all of the elements of intrastate ratemaking to the States. On its face, Section 152(b)1 clearly shows an intent to preserve State autonomy over all of the elements of intrastatate ratemaking. This detailed reservation of specific State ratemaking authority is repeated in Sections 221(b) and 410(b) of the Act.[11] Since State autonomy over all elements of intrastate telephone rates is preserved under the Communications Act, the purpose of Section 220(b) is limited to setting interstate rates.

Further, Section 152(b)(1), the Respondents' admit, was proposed by NARUC to overcome the *Shreveport* power possessed by the ICC. When NARUC objected to the Senate's version of subsection (j), which explicitly preempted State authority over depreciation for all intrastate ratemaking, it described the Bill as *Shreveporting* the States. Quite clearly, the *Shreveport* power encompassed more than Federal authority to set final rates. It included Federal preemption of the individual elements of intrastate ratemaking and, specifically, depreciation. Thus, the purpose of Section 152(b)1 extends to depreciation as an element of intrastate ratemaking. The Respondents' reading of Section 220(b) contravenes that purpose.

Unlike the Interstate Commerce Act, the Communications Act provides for the division of telephone plant for ratemaking

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[10] 47 U.S.C. §152(b)1.

Contrary to the assertion of GTE, Section 152(b)1 is not a paraphrase of Section 1(2) of the Interstate Commerce Act. Quite clearly, Section 152(b)1 is more foreceful, more comprehensive and more explicit than Section 1(2).

[11] 47 U.S.C. §§221(b) and 410(b).

purposes. Consistent with *Smith v. Illinois Bell Telephone Company*, 282 U.S. 133 (1930), Section 221(c) provides for FCC division of plant between interstate and intrastate ratemaking jurisdictions.[12] Thus, the investment recorded on a utility's accounts, including the depreciation of that investment, is allocated to separate jurisdictions for ratemaking purposes.

Unlike the Interstate Commerce Act, the Communications Act explicitly preserves State autonomy to determine the value of all telephone plant allocated to intrastate jurisdiction. Section 213(h) provides that FCC valuations have no effect on State authority.[13] Thus, the States are free to apply their own standards of valuation of utility investment for ratemaking purposes.[14] It would be incongruous to provide for State autonomy in valuing investment while requiring rigid conformance to Federal prescriptions of the rate at which that investment depreciates.[15]

Respondents contend that the Congressional intent to preempt the States under Section 220 is evidenced by the passage in the Natural Gas Act and the Federal Power Act of language similar to the language offered by the States for inclu-

[12]47 U.S.C. §221(c).

The FCC has adopted a separations procedures which it has codified in 47 C.F.R. Part 67. The FCC's regulations allocate investment in purely interstate plant directly to its jurisdiction, allocate investment in purely intrastate plant directly to the States and allocate investment in common-use plant to each jurisdiction according to relative usage.

[13]47 U.S.C. §213(h).

[14]Section 213(h) repudiates AT&T's assertion that Congress determined that a piece of property located in one place depreciates at one rate. Under Section 213(h), property need not even have a single *value*, let alone a single rate of depreciation.

[15]Any notion of unified FCC regulation of depreciation is dispelled by Section 152(b)2, which exempts "connecting carriers" from Section 220. The States, not the FCC, prescribe the depreciation rates for these carriers.

sion in the Communications Act but rejected by the Congress.[16] This, however, does not support the contention that Congress intended to deprive the States of the independent authority to set depreciation rates for intrastate ratemaking.

Noticeably absent from both the Natural Gas Act and the Federal Power Act are both the separations of jurisdiction provision in Section 221(c) and the detailed division and separation of State and Federal ratemaking authority in Sections 152(b)(1), 221(b) and 410(b).[17] Thus, it was necessary to insert specific language preserving State authority over depreciation for ratemaking purposes in those Acts. What was found to be offensive in NARUC's proposal was the possibility of inconsistent *accounting* requirements. The presence in the Communications Act of provisions recognizing the State's right to establish the methods and elements of intrastate ratemaking made it unnecessary for the Congress to grant redundant authority in subsection (j).

E. The FCC's implementation of Section 220 denies any Congressional intent to preempt.

The FCC's implementation of Section 220 shows that preemption by Statute is far from "unmistakably ordained" by Congress. The FCC "discovered" Congress' intent 49 years after enactment of Section 220 and after almost four decades of active enforcement of its provisions.

The FCC was granted authority to prescribe depreciation rates in 1934 and began to actively do so in the 1940's. It was not until 1983 that the FCC "discovered" the true meaning of Sec-

[16]When Congress passed the Natural Gas Act and the Federal Power Act, they included provisions reserving State authority to set depreciation rates for *ratemaking* purposes. These provisions are *not* similar to NARUC's version of 220(j). See 16 U.S.C. §825a(a) and 15 U.S.C. §717h(a). Notably, these two Acts contain State participation provisions virtually identical to Section 220(i).

[17]47 U.S.C. §152(b), 221(b), 221(c) and 410(b).

tion 220(b) and determined that Congress intended to preempt the States as a matter of law.[18] This occurred after almost four decades of contrary practice by the FCC and after a contrary ruling just the year before.[19] Congress could not have "unmistakably ordained" preemption if it took the FCC 49 years to realize this fact.

Though it had actively prescribed depreciation rates for almost 40 years, the FCC never before took the position that its prescriptions were preemptive, absent exemptions under 220(h). No FCC order, notice or regulation issued during that 40-year period even *hints* that FCC depreciation prescriptions were preemptive. The States claimed the right to deviate from FCC prescriptions and deviated from those prescriptions on occasion. The FCC's continual silence is clear and unmistakable evidence that the FCC had, for 49 years, viewed Section 220(b) as not binding the States at all.

The FCC's rejoinder is a deft assertion that it had no cause to exercise its dormant "power to preempt" because the States generally followed FCC prescriptions. This assertion is specious, for it contradicts the very interpretation that the FCC has given Section 220: Subsection (b) preempts the States unless the FCC *acts affirmatively* to exempt carriers.[20] The dormant power, under the FCC's new interpretation of Section 220 is not to *preempt*, it is to *exempt*. The FCC's silent acquiescence to past State deviation and its failure to ever hint at a preemptive effect to its prescriptions refute its new interpretation of Section 220. The FCC's not too subtle shift in its interpretation of Section 220 is simply an effort to avoid the issue.

[18]See *In the Matter of Amendment of Part 31*, 92 F.C.C. 2d 864 (1983) (*1983 Preemption Decision*).

[19]See *In the Matter of Amendment of Part 31*, 89 F.C.C. 2d 1094 (1982) (*1982 Preemption Decision*). Respondents incorrectly State that the *1982 Preemption Decision* found Section 220 not to preempt by a 3 to 2 vote. In fact, the two dissenting Commissioners made no mention of preemption as a matter of law, but limited their discussion to the existence of frustration.

[20]*See 1983 Preemption Decision*, 92 F.C.C. 2d at 870.

The FCC's scattered references to "waivers" in certain regulations and orders are disingenuous. First, they are not exemptions from the requirements of Section 220. Second, they mix accounting prescriptions with depreciation prescriptions, contrary to the FCC's view of Section 220. Third, the FCC's first codification of its Uniform System of Accounts in 47 C.F.R. Part 31 (1939) cited Section 220(a) as its authority. No citation to Section 220(h) was made. In fact, no regulation or order issued by the FCC prior to its *1982 Preemption Decision* even mentions Section 220(h).

AT&T's and FCC's assertion that the FCC may "change" its interpretation of Section 220 is nothing short of a claim of an administrative power to legislate. This claim is particularly offensive in view of the fact that Title II of the Communications Act clearly shows a Congressional intent to define the relationship of Federal and State authority by statute rather than leave the matter to administrative discretion. Further, their assertion directly contradicts subsection (j), which directs the FCC to seek legislation to change the meaning of Section 220. Ultimately, their assertion offends the principles stated by this court in *Alessi v. Raybestos-Manhattan, Inc., supra,* for it substitutes agency discretion for Congressional intent.

II. The FCC Lacks authority to preempt depreciation policy for intrastate ratemaking purposes.

Summary

The Communications Act demonstrates a clear intent that telephone communication be subject to dual regulation. Congress intended that State regulation of intrastate communications be complete and that it be unhindered by possible FCC intervention. The Act does not permit FCC preemption of separable intrastrate regulations simply to advance Federal policy. The FCC may preempt only when State regulation encroaches

on Federal authority, such as when a particular subject will not permit dual regulation.

A. On its face, the Communications Act shows a scheme of dual regulation of telephone communication.

Congress adopted the Communications Act with the intent that telephone communication should be subject to dual regulation as an act of Federal/State comity. Congress intended that the FCC exercise jurisdiction only over interstate telephone communication and that the States exercise jurisdiction over intrastate comunication without threat of Federal intervention. As a contrast, under title III – "Regulation of Interstate Broadcasting," the FCC was granted authority to regulate interstate broadcast communication and all matters that affected such communication.[21] Thus, Title III regulation was intended to be truly unified. On the other hand, Title II – "Regulation of Interstate Telephone Communication" is subject to numerous reservations of State authority.[22] Read as a whole, the provisions of the Act governing telephone regulation demonstrate a clear intent by Congress to preserve State authority over all aspects of intrastate telephone communication.

Section 152(a) provides FCC jurisdiction over interstate communication, while Section 152(b) modifies the more general provisions of Section 152(a). Section 152(b) was intended to preserve State authority over all aspects of intrastate communication.[23] It does not withdraw FCC authority to regulate

[21]Once a person becomes subject to FCC licensing under Section 301 (47 U.S.C. §301), he is fully subject to FCC authority.

[22]E.g.: Even though a carrier is subject to FCC authority because it carries interstate telephone communication, FCC authority is specifically limited to the direct regulation of interstate communication. Even then, FCC authority does not extend fully, for certain aspects of interstate communication are withheld from the FCC in favor of State regulation.

[23]The States' jurisdiction is preserved over "charges, classifications, practices, services, facilities, or regulations for or in connection with intrastate communication service by wire or radio of any carrier."

interstate communication. It simply limits the means by which that authority is to be exercised and the manner in which the goals stated in Section 151 of the Act are to be achieved.[24]

Under Section 152(b)1, the States retain their authority to regulate each element of ratemaking, as well as regulations, service and facilities used "for or in connection with" intrastate telephone service. Such authority is essential to State regulation of intrastate communications. For instance, local exchange facilities originate and terminate interstate toll service and are common-use facilities. Section 152(b) preserves State authority over common-use plant so that the States may regulate the local incidents of communication service.

The States do not argue, as the Respondents claim, that the FCC is deprived of authority over common-use facilities by Section 152(b)1. Occasions do arise where compliance with both FCC and State regulation is impossible. In those few cases, Sections 152(a) and 152(b)1 cannot be reconciled by their own terms, for FCC and State authority cannot coexist. One must prevail over the other. Hence, FCC authority must prevail where dual regulation is impossible. However, where a subject is severable and compliance with inconsistent FCC and State regulations is possible, the intent of Section 152 is clear: FCC and State authority is to coexist under a framework of dual regulation. The jurisdictional separations provisions of Section 221(c) clearly demonstrate the divisibility of depreciation policy. Once investment is allocated to its respective Federal/State jurisdiction, the rate at which that investment is returned (depreciation rate) may be set by each jurisdiction without affecting the authority of the other.

B. The Legislative history of the Act demonstrates an intent to preserve state authoriy.

The reason that the Communications Act contains various provisions safeguarding State authority is that the States were

[24]47 U.S.C. §151.

actively involved in writing the Act. State representatives helped prepare the text of the Senate and House Bills. They presented the Bills at Congressional hearings and explained at length the need to preserve State authority.

The State representatives sought to ensure that State regulatory bodies were not ousted from their jurisdiction.[25] NARUC actually favored the bills, for they established effective Federal regulation of matters that were difficult for the States to reach.[26] Representatives of State commissions felt that the bills preserved the rights that the States should possess.[27] Congress accepted the States' contention that State authority should be preserved and enacted provisions proposed by the States. The legislative history of the Act confirms that the scheme of dual regulation that appears on the face of the Act is, indeed, the intent of Congress.

C. The regulatory scheme proposed by the Respondents defies the provisions of the Act and its legislative history.

Respondents present this Court with a regulatory scheme in which the FCC has exclusive jurisdiction over virtually all telephone facilities in the nation and plenary authority to preempt any State regulation of intrastate communication that affects interstate communication. The Respondents urge that, at most, the States *may* be free to set intrastate rates, provided that they do so in conformance with FCC prescribed policies. This, of course, if the scheme Congress adopted under Title III of the Communications Act. It is *not* the scheme of regulation under Title II of the Act.

Respondents urge that the FCC's authority over facilities used for interstate communication is exclusive and that the States

[25]Senate Hearings at 153; House Hearings at 140.

[26]Senate Hearings at 155, 156; House Hearings at 69, 132, 136.

[27]Senate Hearings at 1154; House Hearings at 74.

have no authority over common-use facilities. Respondents claim that Section 152(b)1 only reserves State authority over purely intrastate facilities. Section 152(b)1 lends itself to no such reading, for it preserves State authority over "facilities . . . for *or in connection with* intrastate communication by wire or radio."

The Respondents reading of Section 152(b)1 also contradicts the terms of Section 221(b), which preserve State authority over "services [or] facilities for or in connection with wire telephone exchange service" when a portion of such service includes interstate communication. Since local exchange facilities are used for both interstate and intrastate communication, the Respondent's theory renders Section 221(b) meaningless. Congress would not have preserved State authority over common-use facilities that cross State lines if the States lacked authority over those facilities pursuant to Section 152(b)1. A harmonious reading of the two Sections occurs when Section 152(b)1 is read to preserve State authority over *all* facilities used for intrastate communication service and Section 221(b) is read to extend that protection to circumstances where local exchanges cross State lines.

The Respondents' claim of exclusive FCC authority over all common-use facilities is disproven by other provisions of the Act. In some cases it is the State and not the FCC that regulates common-use facilities. For instance, Section 214, which provides for FCC approval of new or extended telephone lines, prevents FCC supervision of local, branch or terminal lines up to 10 miles in length.[28] Moreover, since "connecting carriers" are completely exempted from Section 214 by Section 152(b)2, all extensions of their facilities are regulated by the States.

Further, the Respondent's theory leads to an absurd result. If the States lacked authority over local exchange plant, it would be virtually impossible to regulate local telephone service. Aside

[28]47 U.S.C. §214.

from the fact this proposition defies Section 221(b), it could create a void in the regulation of telephone communication. The States could not regulate the terms and conditions of local exchange service or the quality of local exchange service. The FCC has no capacity to supervise local exchagne service provided to millions of customers across the nation. It is difficult to believe that Congress intended that the FCC be the sole means of redress to a local exchange customer when a company provided poor service, or no service at all.

Contrary to the Respondent's claims, the purpose of Section 152(b)1 goes beyond the protection of State power to set the ultimate rates for intrastate service. By its terms, Section 152(b)1 is more forceful and comprehensive than Section 65 of S.6, cited by GTE as its predecessor.[29] Section 152(b)1 states that nothing in the Act shall be construed to *apply* or to give the Commission *jurisdiction with respect to* intrastate charges, classifications, practices, services, *facilities,* or *regulations.* In contrast, Section 65 of S. 6 simply prohibited direct FC regulation of intrastate rates, charges or service to remove discrimination against interstate commerce or for other purposes. Section 152(b)1 shows an intent to protect all elements of intrastate communication regulation from both direct and indirect FCC authority.[30]

The FCC's misplaced claim of preemptive authority rests upon a line of cases following from *North Carolina Utilities Commission v. F.C.C.,* 437 F.2d 787 (4th Cir. 1976), *cert. denied,* 429 U.S. 1027 (1976) [NCUCI]. The *NCUC* cases recognize that when dual regulation is impossible, FCC jurisdiction must prevail. Hence, the following language appears in each case: ". . . [W]e are not persuaded that Section 2(b) sanc-

[29]See Brief of GTE Service Corp., etc., at 28.

[30]Contrary to the Respondents' assertions, the *Shreveport* power involved more than setting final rates. NARUC specifically referred to *Shreveport* in the controversy over Sectin 220(j). House Hearings at 73, Statement of K.L. Clardy.

tions any State regulation, formally restrictive only of intrastate communication, that in effect encroaches substantially upon the Commission's *authority* under Sections 201 through 205" (emphasis supplied).[31]

The FCC's attempt to refute the fact that the *NCUC* cases rested on impossibility of dual regulation is misleading.[32] Even the lower Court recognized that the *NCUC* cases rested on impossibility. The FCC's argument demonstrates that its theory of preemptive authority relies upon ubiquitous logic.

Congress intended to describe the dividing line of FCC and State authority in the text of the Communications Act. If the test of FCC preemptive authority rests upon frustration of Federal policy, the intent of Congress to define the dividing line of FCC and State jurisdiction is defied. Permitting the FCC to preempt intrastate regulations that simply affect interstate communications result in endless hyperbole. The dividing line becomes lost in an endless analysis of "substantial" versus "insubstantial" effect.

Because most carriers provide both interstate and intrastate communication service, every regulation of intrastate communication affects interstate communication. The Respondents theory of preemption will inevitably lead to Federal preemption of all key elements of intrastate regulation. If the power to set final rates is the definition of "ratemaking," the FCC can preempt depreciation, rate of return and expense levels. It can dictate the entire revenue requirement and all principles of rate structure, leaving to the States the mere function of applying the FCC's formula.

A rational division of *jurisdiction* rests upon the attributes of *jurisdiction.* Congress *knew* State regulation would affect in-

[31]The FCC misquotes this sentence by inserting the word "exclusive" before the word "jurisdiction." See Brief for the Federal Respondents at 36.

[32]See Brief for the Federal Respondents at 37.

terstate communication. It nevertheless adopted a scheme of dual regulation. A test of FCC preemptive authority based on the impossibility of dual regulation is faithful to the scheme intended by Congress. Where dual regulation is impossible, State regulation necessarily encroaches on FCC authority. Where the subject is severable, however, there is no encroachment. Each regulatory body can exercise its own authority, as intended by Congress. Depreciation policy for ratemaking purposes is clearly severable between FCC and State authority. Each jurisdiction may set rates and charges for communication service based its own depreciation policy without interfering with the jurisdiction of the other.

CONCLUSION

Section 220 does not preempt depreciation for intrastate ratemaking as a matter of law. Telephone Communication is regulated by the FCC and the States under a system of dual regulation. The FCC lacks authority to preempt depreciation policy for intrastate ratemaking purposes, for that area of intrastate regulation is separable from and does not encroach on FCC authority. The order of the lower court should be set aside and the FCC's Preemption Order should be declared invalid.

Respectfully submitted,

WILLIAM S. BILENKY
General Counsel

PAUL SEXTON
Associate General Counsel

FLORIDA PUBLIC SERVICE COMMISSION
101 East Gaines Street
Tallahassee, Florida 32301-8153
(904) 488-7464

December 27, 1985

Nos. 84-871, 84-889, 84-1054, and 84-1069

In The

SUPREME COURT OF THE UNITED STATES

October Term, 1985

Louisiana Public Service Commission,
Appellant

v.

Federal Communications Commission and United States of America
Appellees

California and Public Utilities Commission of California, *et al.*,
Petitioners

v.

Federal Communications Commission and United States of America
Respondents

Public Utilities Commission of Ohio, *et al.*,
Petitioners

v.

Federal Communications Commission and United States of America
Respondents

Florida Public Service Commission,
Petitioner

v.

Federal Communications Commission and United States of America
Respondents

On Appeal And On Petitions For A Writ of Certiorari To The United States Court of Appeals For The Fourth Circuit

JOINT BRIEF OF THE STATE OF ALABAMA AND THE ALABAMA PUBLIC SERVICE COMMISSION, AS *AMICI CURIAE* IN SUPPORT OF THE APPELLANT AND PETITIONERS URGING REVERSAL

ALABAMA PUBLIC SERVICE COMMISSION
Stephen L. Skipper
William James Samford, Jr.
Susan Shirock DePaola
Post Office Box 1402
Montgomery, AL 36102

STATE OF ALABAMA
Charles A. Graddick*
Attorney General
64 N. Union Street
Montgomery, AL 36130

*Counsel of Record

September 1985

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JOINT BRIEF OF THE STATE OF ALABAMA AND THE ALABAMA PUBLIC SERVICE COMMISSION AS *AMICI CURIAE* IN SUPPORT OF THE APPELLANT AND PETITIONERS URGING REVERSAL

The State of Alabama and the Alabama Public Service Commission, submit their joint brief as *amici curiae* in support of Appellant, the Louisiana Public Service Com-

mission and Petitioners the People of California and the Public Utilities Commission of California, *et al.*, and the Public Utilities Commission of Ohio, *et al.*, and the Florida Public Service Commission. The *amici curiae* submit that the decision of the United States Court of Appeals for the Fourth Circuit in *Virginia State Corporation Commission v. F.C.C.*, 737 F.2d 388 (4th Cir. 1984) should be reversed.

Pursuant to Rule 36.4 of the Rules of this Court, this brief is filed by the State of Alabama by and through its Attorney General.

INTEREST OF *AMICI*

The Attorney General of the State of Alabama appears herein on behalf of the citizens of the State of Alabama who are affected by the Order under consideration. The Alabama Public Service Commission is the body charged with the statutory duty to regulate intrastate rates and charges for telecommunication services. The *amici* submit that the Federal Communications Commission's Order interferes with their duty to ensure that rates are reasonable and just to both the utility and the public.

SUMMARY OF ARGUMENT

The State of Alabama and the Alabama Public Service Commission as *amici curiae* submit that the Fourth Circuit Court of Appeals improperly relied upon Section 151 of the Communications Act in determining the scope of the Federal Communications Commission's authority under the Act. The clear intent of Congress as evidenced by Sections 152(b) and 153(e) was to distinguish between interstate and intrastate ratemaking authority. In evaluating the jurisdiction of the Federal Communications Commission the courts should require a clear showing by the FCC that concurrent regulation is not possible and that continued

joint regulation by State and Federal agencies will have a substantial adverse effect on interstate communications. The FCC does not have general intrastate ratemaking authority and has attempted to assume that authority without making findings of fact in their order which would justify this incursion into an area which has always been subject to concurrent regulation without any substantial adverse effect on interstate communications.

ARGUMENT

I. THE PURPOSE CLAUSE OF THE COMMUNICATIONS ACT DOES NOT SUPERCEDE THE JURISDICTIONAL LIMITATIONS PLACED UPON THE FEDERAL COMMUNICATIONS COMMISSION.

The decision by the Fourth Circuit in the *Virginia*[1] case relies upon the purposes outlined by Congress for the FCC in the Communications Act[2], without considering the jurisdictional limitations contained in the Act. This reliance on Section 151 is misplaced, and constitutes reversible error.

The Communications Act sets forth the following statement of purpose for the Commission:

> . . . To make available, so far as possible, . . . a rapid, efficient, nationwide, and worldwide wire and radio communication service with adequate facilities at reasonable charges . . .[3].

This statutory mandate provides the Federal Communica-

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[1] *Virginia State Corp. Comn. v. Federal Communications Commission*, 737 F.2d 388 (4th Cir. 1984).

[2] 47 U.S.C. §151 *et. seq.*

[3] 47 U.S.C. §151.

tions Commission (hereinafter "FCC") with an explicit objective, and presumably all of their activities are guided by this statement of purpose.

This statement of purpose, however, is <u>not</u> a statement of jurisdiction, and, in fact, Section 151 contains express limitations on the authority of the FCC. It may act only "so far as possible"[4] within the jurisdictional restrictions set forth in the Communications Act to carry out this objective. Despite these express limitations, the Fourth Circuit found it "unneccessary to decide whether as a matter of law, the language of the Act itself requires preemption."[5]

In allowing preemption of all conflicting state regulations regarding depreciation, the Fourth Circuit relied upon the FCC's stated objective of encouraging competition, which apparently, the FCC believes will further its statutory mandate to provide a "rapid" and "efficient" communication network. It is clear, however, that the FCC's "goal" need not "in all cases take precedent, especially where the FCC's jurisdiction is explicitly denied under other provisions of the Act"[6].

In *Hines v. Davidowitz*[7] this Court stated that state law is preempted if it "stands as an obstacle to the accomplishment of the full purposes and objectives of Congress."[8] This broad principle must be read, however, in light of this Court's later cases which suggest that promotion of federal objectives is not to be accomplished "at all costs."[9] Thus,

[4]47 U.S.C. §151.

[5]*Virginia State Corp. Comn., supra* at 392.

[6]*National Association of Regulatory Utility Commissioners v. Federal Communications Commission*, 533 F.2d 601, 613 (D.C. Cir. 1976).

[7]*Hines v. Davidowitz*, 312 U.S. 52 (1941).

[8]*Id.* at 67.

[9]*Pacific Gas and Electric Company v. State Energy Resources Conservation & Development Commission*, 461 U.S. 190, 103 S.Ct. 1713, 1731 (1983).

Federal policies or objectives must give way "where Congress has left sufficient authority with the State"[10] to act in a manner that would, in effect, "undercut a federal objective".[11]

In the case currently before this Honorable Court, the FCC's jurisdiction has been explicitly denied under Section 152(b) of the Communications Act. It is also apparent that the "Commission was not delegated unrestrained authority"[12] under the Act and that particular jurisdictional limitations may serve to constrain the FCC's activities in furtherance of its statutory objectives. Further, the FCC's jurisdiction, if limited only by the Congressional statement of purpose, is "unbounded".[13] The Fourth Circuit has ignored the specific limitations placed upon the FCC by virtue of the statutory grant of jurisdiction contained in Section 152(a) and the specific denial of jurisdiction contained in Section 152(b).

Obviously a balance must be struck between the objectives set forth in the Act, and the specific jurisdictional limitations contained in the Act. The prior decisions of the lower Courts, which will be examined in Section III of this brief, provide a basis for a realistic balance between the stated objectives and the statutory jurisdictional limitations by which the FCC is constrained in its authority to act.

[10]*Id.* at 1732.

[11]*Id.* at 1732. See also, *Commonwealth Edison Co. v. Montana*, 453 U.S. 609, 633 (1981) in which this Court rejected the argument that a statement of basic national policy in a particular field will serve to preempt conflicting state laws.

[12]*Federal Communications Commission v. Midwest Video Corp.*, 440 U.S. 689, 706, 99 S.Ct. 1435, 1444 (1979).

[13]*Id.* at 1444.

II. CONGRESS HAS RESERVED JURISDICTION TO THE STATES, THROUGH THE FEDERAL COMMUNICATIONS ACT, TO PRESCRIBE CLASSES OF PROPERTY AND PERCENTAGES TO BE ALLOWED AS DEPRECIATION FOR INTRASTATE COMMUNICATION SERVICES.

The FCC erroneously relies heavily on Section 220(b) to override the jurisdictional limitations Congress explicitly set out in Section 152(b).[14] Section 220 is not without distinctions between interstate and intrastate jurisdictions. The Act provides that the FCC may prescribe forms of accounts, records, and memoranda to "carriers subject to the Act".[15] Section 220(b) allows the FCC to, "provide for such carriers the classes of property for which depreciation charges may be properly included under operating expenses, and the percentages of depreciation which shall be charged with respect to each of such classes of property, classifying the carriers as it may deem proper for this purpose . . ."[16] While Sections 220(a) and (b) give the FCC authority to prescribe classes of property and percentages to be allowed as depreciation, the authority is limited by Section 152(b).

Even without the distinction built in to Section 220 itself, Section 152(b) states that "nothing in this Act shall be construed to apply or to give the Commission jurisdiction"[17] over intrastate communications; therefore, Sections 220(a) and (b) cannot be construed so as to apply to intrastate communications when read in light of Section 152(b).

[14]*Amendment of Part 31*, 92 F.C.C.2d 864, (1983) (hereinafter *"Preemption Order"*).

[15]47 U.S.C. §220(a)

[16]47 U.S.C. §220(b).

[17]47 U.S.C. §152(b).

The FCC is granted jurisdiction over interstate communication in Section 152(a) and expressly prohibited from exercising jurisdiction over "charges, classifications, practices, services, facilities, or regulations for or in connection with intrastate communication service by wire or radio"[18] in Section 152(b)(1).

Congress has defined interstate communications and transmissions, for purposes of the Act, as communications and transmissions:

> from any State, Territory, or possession of the United States . . . to any other State, Territory, or possession of the United States . . . but shall not, with respect to provisions of title II of this Act include wire or radio communication between points in the same State, Territory, or possession of the United States, or the District of Columbia, through any place outside thereof, if such communication is regulated by a State commission.[19]

The Communications Act provides that "interstate communication" or "interstate transmission" means communication or transmission as defined in that section.[20] "A definition in a statute that declares what a term means, as opposed to what the definition includes, excludes any meaning that is not stated."[21] It is clear when reading Section 153(e) that Congress has not included, and has, in fact, expressly prohibited the FCC from exercising juris-

[18]47 U.S.C. §152(b).

[19]47 U.S.C. §153(e).

[20]47 U.S.C. §153(e).

[21]*Colautti v. Franklin*, 439 U.S. 379 (1978), *Meltzer v. Zoller*, 520 F.Supp. 847 (D.N.J. 1981).

diction over intrastate activities and has limited their jurisdiction to communication or transmission from any state to any other state.

The FCC's interpretation of its statutory authority renders Sections 152(b) and 153(e) virtually meaningless by obliterating the distinction between the interstate and intrastate jurisdictions.

An attempt must be made, as the FCC failed to do, to construe "each part or section . . . in connection with every part or section so as to produce a harmonious whole. It is not proper to confine interpretation to the one section to be construed".[22] In construing Sections 220(a) and (b) in light of the limitation to carriers subject to the Act described in Section 152(a), there is harmony which allows all sections to be given effect. This construction shows a clear intent on the part of Congress to reserve to the states, authority over prescribing classes of property and percentages to be allowed as depreciation for intrastate communications.

III. THE COURT FAILED TO USE THE PROPER TEST IN EVALUATING THE JURISDICTION OF THE FCC.

The *amici* submit that the FCC should only have jurisdiction over the rates and service regulations of the intrastate portion of jointly used facilities or services upon a clear showing that concurrent regulation is not possible and upon a clear showing of a substantial adverse effect upon interstate communications services of particular intrastate charges, classifications or regulations.

[22] *Juvenile Products Manufacturers Assoc., Inc. v. Edmisten*, 568 F.Supp. 714, (E.D.N.C. 1983); A. Sutherland, 2A *Statutes and Statutory Construction*, §46.05, 56 (4th Ed., Sands Ed. 1973).

The issue presented in this case is the extent of the authority of the FCC to prescribe depreciation accounting practices for the portion of costs allocated to the intrastate jurisdiction.[23] The court below made an abrupt departure in its review of the FCC from the method of review adopted in previous decisions.

In *North Carolina Utilities Commission v. F.C.C.* (hereinafter "*NCUC I*")[24], the Fourth Circuit ruled that the North Carolina Utilities Commission could not prohibit the interconnection of terminal equipment except for use exclusively with facilities separate from those used in intrastate communications. The Fourth Circuit found that "[u]sually it is not feasible, as a matter of economics and practicality of operation, to limit the use of such equipment to either interstate or intrastate transmissions."[25] The court noted that the FCC had initially determined that blanket prohibitions against interconnection are unjustifiably discriminatory.[26] In evaluating the conflicting positions of interstate and intrastate regulators, the court stated:

> We have no doubt that the provisions of section 2(b) deprive the Commission of regulatory power over local services, facilities and disputes that in their nature and effect are separable from and do not substantially affect the conduct or development of interstate communications.[27]

[23] Part I *infra*. The investment costs associated with jointly used facilities are allocated under Part 67 as mandated in *Smith v. Illinois Bell Telephone Company*.

[24] *NCUC I*, 537 F.2d 787 (4th Cir. 1976).

[25] *NCUC I*, *supra* at 791.

[26] *Id.* at 792, citing *Carterfone v. AT&T*, 13 F.C.C.2d 420, *recon den.*, 14 F.C.C.2d 571 (1968).

[27] *NCUC I*, *supra* at 793.

The court determined that concurrent federal and state regulation was not feasible in that case, and that the ability to interconnect terminal equipment to the local exchange network has a substantial effect on interstate communications.

In *Computer and Communications Industry Association v. F.C.C.*[28] the D.C. Circuit reasoned that the FCC's jurisdiction is paramount whenever state regulation interferes with the achievement of a federal regulatory goal.[29] The court stated,[30] however, that its application of this broad mandate was in accord with the jurisdictional limitations adopted in *NCUC I*. The court apparently believed that concurrent federal and state regulation of customer premises equipment (hereinafter "CPE") and enhanced services was not possible[31] and that there would be a substantial adverse effect produced by continued state regulation.[32] The FCC wanted the charges for CPE to be separated from the flat monthly rates so customers choosing to purchase and interconnect their own equipment would not be forced to subsidize company provided CPE.[33] The FCC also chose to deregulate the sale and lease of new CPE in order to promote competition of that service. The court, however, emphasized that its sanction of the FCC's

[28]693 F.2d 198 (D.C. Cir. 1982).

[29]*Id.* at 214.

[30]*Id.* at 215.

[31]*Id.* at 216 wherein the court stated: "...state tariffs would interfere with the consumer's right to purchase CPE separately from transmission service . . ."

[32]*Id.* at 216, wherein the court stated: "the conflicting state policy meant to affect only intrastate use would unavoidably affect the federal policy adversely."

[33]*Second Computer Inquiry*, 77 F.C.C.2d 198 (hereinafter "*Computer II)*".

decision in *Computer II*, "is a very narrow one, given in light of the peculiar nature of the communications and data processing industries . . .".[34]

In the Preemption Order the FCC did not clearly state the substantial federal interest affected by depreciation charges.[35]

The court of appeals erred by failing to consider the jurisdictional limitations of the FCC[36] and failed to correct its error by attempting to rationalize its decision, stating, "physical impossibility is but one ground for preemption . . ."[37] and "[s]ince inconsistent state regulation poses an impediment to rapid development of interstate facilities, preemption is justified in this case even if 'physical impossibility' is not an issue."[38] The court below found that "the instant appeal raises no question of actual physical impossibility of complying with dual federal and state regulation, presumably, the carriers could keep accounts in which assets would be separately depreciated for intrastate and interstate purposes."[39]

The jurisdictional test adopted by the 4th Circuit in *NCUC I* unfairly places the burden of proof on the states to prove that state regulation does not have a substantial adverse effect on interstate communications. This problem

[34]*Id.* at 210.

[35]Parts III and IV *infra*.

[36]*Id.* at 392, wherein the court stated: "Because we have determined that the affirmative regulatory action taken by the FCC suffices to preempt inconsistent state action, we find it unnecessary to decide whether, as a matter of law, the language of the Act itself requires preemption."

[37]*Id.* at 396.

[38]*Id.* at 396.

[39]*Virginia State Corp. Comn., supra* at 396.

is clearly illustrated in the case at bar from the FCC's statement: "Here the setting of depreciation rates is not an essential local incident or practice . . ."[40] The issue should not focus on the interest of the states but upon the legitimate interests of the FCC.

In light of the specific reservation of power to the states contained in the Act, the burden should be shifted and the test reformulated. The FCC should only have jurisdiction over the intrastate portion of jointly used facilities or services upon a clear showing by the FCC: (1) that it is not possible for the charges, classifications or regulation of such facilities or services to be reasonably separated between concurrent interstate and intrastate jurisdictions, and (2) that specific intrastate rates or service regulations will have a substantial, adverse effect upon interstate communications services. If specific intrastate charges, classifications or regulation of jointly used facilities or services is susceptible to concurrent regulation then the FCC should not be allowed to preempt state regulation. All of the previous cases discussed hereinabove conform with this method of review.

IV. RULEMAKING ORDERS PROMULGATED BY THE FCC ARE REQUIRED TO BE SUPPORTED BY FINDINGS OF FACT STATED IN THE ORDER.

The FCC failed to clearly state a factual basis for its decision in the Preemption Order and the court below erred in failing to review the factual basis of the FCC's decision. The FCC is required to clearly state their findings of fact in their rulemaking orders pursuant to Section 553 of the Administrative Procedures Act.[41] Judicial construction

[40]*Preemption Order, supra* at 875, ¶ 30.

[41]5 U.S.C. §500 *et seq.*

imposes fact finding requirements that go well beyond the minimal requirements contained in Section 553.[42]

The judicial trend toward more stringent requirements for findings of fact in federal agency proceedings began with the decision in *Automotive Parts & Accessories Assn., Inc. v. Boyd.*[43] In that case, the court found that Section 553 required federal agencies to make findings which would "enable [the court] to see what major issues of policy were ventilated by the informal proceedings and why the agency reacted to them as it did . . . ."[44]

The requirements of Section 553 were also at issue in *Kennecott Copper Corp. v. EPA.*[45] In that case, the court remanded the adoption of a new EPA guideline because there was an insufficient foundation upon which to base the new standard. The court noted that "there are contexts . . . in which the minimum requirements of the Administrative Procedure Act may not be sufficient."[46] More specifically, in *Portland Cement Assn. v. Ruckelshaus*[47] the court noted, "it is not consonant with the purpose of a rule-making proceeding to promulgate rules on the basis of inadequate data, or on data that to a critical degree is known only to the agency."[48]

Further guidance can be drawn from *P.A.M. News Corp. v. Hardin*[49] in which the court noted, "administrative agencies must give reasoned consideration to all the material facts and issues presented to them in the rule-making

[42]Kenneth Culp Davis, 1 *Administrative Law Treatise* §6:1 *et seq.* (1978).

[43]407 F.2d 330 (D.C. Cir. 1968).

[44]*Id.* at 338.

[45]462 F.2d 846 (D.C. Cir. 1972).

[46]*Id.* at 850.

[47]486 F.2d 375 (D.C. Cir. 1973).

[48]*Id.* at 395.

[49]440 F.2d 255 (D.C. Cir. 1971).

proceeding and must articulate with reasonable clarity their reasons for decision."[50]

Perhaps the best summary of the requirements for findings of facts can be found in *General Tel. Co. of the Southwest v. U.S.*[51] in which the court stated:

> It is clear that the findings required of an agency in its rule-making capacity are of a different nature from those required in adjudication . . . it is not expected that the agency will discuss in detail every item of fact or opinion included in the comments submitted to it. However, it is expected, if judicial review is to serve its purpose, that the agency's concise general statement mandated by Section 553 will enable us to see what major issues of policy were ventilated by the informal proceedings and why the agency reacted to them as it did.[52]

Therefore, the *amici* submit that the Preemption Order is deficient in failing to provide a factual basis for the decision and the court below committed reversible error in failing to require the Commission to do so.

V. THE FCC DOES NOT HAVE GENERAL INTRASTATE RATEMAKING AUTHORITY.

The FCC presented an array of reasons supporting its preemption of state regulation, but it applied its reasoning to the full spectrum of intrastate regulation without identifying any particular charges or service regulations which substantially affect interstate communications. The depreciation expense and depreciation reserve components included in the calculation of the intrastate revenue requirement cannot cause any effect on interstate com-

[50]*Id.* at 258.

[51]449 F.2d 846 (5th Cir. 1971).

[52]*Id.* at 862.

munications. Only rates and service regulations can affect interstate communications.

The FCC presented in the Preemption Order the following reasons as grounds for its action: 1) To accelerate the implementation of new technology; 2) To provide for more timely capital recovery; 3) To facilitate the raising of additional investment capital; 4) To make intrastate rates reflect cost based pricing; 5) To facilitate the deregulation of CPE; and 6) To eliminate inequities of shifting usage patterns. The FCC did not state that it is concerned with the quality of existing facilities, the replacement rate for existing facilities, or the rate at which innovations are being developed. The FCC has only implied that the overall level of earnings from intrastate services are inadequate, and that intrastate rates do not adequately reflect the underlying costs of providing some unidentified services.

In support of the FCC's desire to accelerate modernization, the FCC merely stated the conclusion that equal life group and remaining life depreciation, "more closely approximate straight line depreciation"[53] and that, "[m]ore timely capital recovery results in faster technological innovation . . . ."[54] The FCC does not, however, explain how these two depreciation practices result in faster technological innovation. It is well known that a utility plant can be replaced at any time regardless of its net book value or depreciation accounting practices.[55]

In relation to the need to raise additional investment capital, the FCC insinuates that without its two depreciation methods, investors will be sent "improper signals"[56]

[53]*Id.* at 876, ¶ 35.

[54]*Id.*

[55]California brief, Part C2, p. 54.

[56]*Preemption Order*, at 877, ¶ 37.

and "could well impair their [the companies'] ability to raise the investment they need to fully compete . . . ."[57] Unless an investor assumes that the company will not recover an abandonment loss upon the replacement of equipment, an investor would not be very concerned with the accounting procedure under which the loss will be recovered.

The primary basis for the FCC's arguments clearly appear to be a perceived inadequacy of the level of intrastate earnings and an inadequacy of the general intrastate rate design. The FCC wants to increase retained earnings for capital construction and to increase returns on common equity in order to attract investors.

The FCC also appears to want intrastate rates to strictly reflect costs, but the FCC does not argue in its order that its actions require cost based pricing. Telephone rates can be priced in many different ways based on a variety of cost support data.

The Fourth Circuit committed reversible error and the Preemption Order should be reversed on the grounds that the adequacy of overall intrastate revenue requirements, the overall rate of return from intrastate operations, and the intrastate cost of service methods are factually outside of the jurisdiction of the FCC. The FCC must be required to identify a specific intrastate charge or service regulation which substantially affects interstate communications, or Section 152(b) will be rendered meaningless.

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[57] *Id.*

Respectfully submitted on this the 9th day of September, 1985.

Charles A. Graddick*
Attorney General
State of Alabama
64 N. Union Street
Montgomery, AL 36130

Stephen L. Skipper
Legal Advisor
Alabama Public Service
Commission
Post Office Box 991
Montgomery, AL 36130

Wm. James Samford, Jr.
Susan Shirock DePaola
Of Pappanastos
& Samford, P.C.
Post Office Box 1402
Montgomery, AL 36102

*Counsel of Record

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Nos. 84-871, 84-889, 84-1054, and 84-1069

In The

Supreme Court of the United States

October Term, 1984

Louisiana Public Service Commission, Appellant

v.

Federal Communications Commission and United States of America

California and Public Utilities Commission of California, et al., Petitioners

v.

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Public Utilities Commission of Ohio, et al., Petitioners

v.

Federal Communications Commission and United States of America

Florida Public Service Commission, Petitioner

v.

Federal Communications Commission and United States of America

On Appeal And On Petitions For A Writ Of Certiorari To The United States Court Of Appeals For The Fourth Circuit

JOINT BRIEF OF THE STATE OF MAINE, MAINE PUBLIC UTILITIES COMMISSION, AND OTHER STATE COMMISSIONS AS AMICI CURIAE IN SUPPORT OF THE APPELLANT AND PETITIONERS URGING REVERSAL

James E. Tierney
Attorney General of Maine
State House
Augusta, Maine 04330

Joseph G. Donahue,
General Counsel
Maine Public Utilities
Commission
242 State Street
Augusta, Maine 04333

William E. Furber
Hayden and Furber
173 Park Row
Brunswick, Maine 04011

Counsel of Record

Attorneys for the State of Maine and the Maine Public Utilities Commission
(Additional *Amici* listed on inside)

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30 pp

Ray H. Walton
Commerce Counsel
North Dakota Public
Service Commission
State Capitol
Bismarck, North Dakota 58505

William C. Harrelson
General Counsel
Missouri Public Service
Commission
P. O. Box 360
Truman State Office Building
Jefferson City, MO 65102

John E. Archibold
Special Assistant
Attorney General
Public Utilities Commission of
the State of Colorado
Logan Tower, Office Level 2
1580 Logan Street
Denver, Colorado 80203

Kirk J. Emge
General Counsel
Public Service Commission
of Maryland
231 East Baltimore Street
Baltimore, Maryland 21202

Ellyn Elise Crutcher
Counsel
Kentucky Public Service
Commission
730 Schenkel Lane
P. O. Box 615
Frankfort, KY 40602

Thomas Weis
General Counsel
Vermont Public Service Board
120 State Street
Montpelier, Vermont 04602

Robert A. Nelson
Chief Counsel
Montana Public Service
Commission
2701 Prospect Avenue
Helena, Montana 59620

Mary L. Vanderpan
Assistant Attorney General
South Dakota Public
Utilities Commission
Capitol Building
Pierre, South Dakota 57501

Georgia Public Service
Commission
By: Michael J. Bowers
Attorney General
James O. Llewellyn
Senior Asst. Atty. General
Michael J. Henry
Asst. Atty. General
132 State Judicial Bldg.
Atlanta, GA 30334

Elizabeth Celis
Attorney, Legal Dept.
Arizona Corporation
Commission
1200 W. Washington St.
Phoenix, Arizona 85007

Steven Clark
Attorney General of Arkansas
Justice Building
Little Rock, Arkansas 72203

John Doehm
Assistant Attorney General
Nebraska Public Service
Commission
301 Centennial Mall South
Lincoln, NE 68509

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The State of Maine, Maine Public Service Commission, the Colorado Utilities Commission, the Missouri Public Utilities Commission, the Montana Public Utilities Commission, the Kentucky Public Utilities Commission, the Maryland Public Service Commission, the South Dakota

Public Utilities Commission, the North Dakota Public Utilities Commission, Nebraska Public Service Commission, Georgia Public Service Commission, Arizona Corporation Commission, Attorney General of Arkansas and the Vermont Public Service Board, hereby submit their joint brief as *amici curiae* in support of Appellant, the Louisiana Public Service Commission, and Petitioners, the People of California and the Public Utilities Commission of California, *et al.*, the Public Utilities Commission of Ohio, *et al.*, and the Florida Public Service Commission. For the reasons set forth below, the decision of the United States Court of Appeals for the Fourth Circuit in *Virginia State Corporation Commission v. F.C.C.*, 737 F.2d 388 (4th Cir. 1984) should be reversed.

The State of Maine has standing to file this brief under Rule 36.4 of the Rules of this Court. Pursuant to Rule 36.2, state commissions joining this brief have obtained the written consent of other parties to this case and have filed them with the Clerk of the Court.

INTEREST OF AMICI

Amici are states and state regulatory commissions. States retain the authority to regulate intrastate rates and services provided by telephone carriers under 47 U.S.C. § 152(b). They have exercised this authority by delegating jurisdiction to state regulatory commissions. The order of the FCC which is the subject of this proceeding purports to preempt the states in the determination of the proper rates of depreciation to be used in setting rates

for intrastate service, a function reserved to state regulatory commissions under 47 U.S.C. 152(b).

SUMMARY OF ARGUMENT

This is the first case in which the FCC has preempted state regulatory authority based on the concern that a federal purpose may be threatened by the *amount* of intrastate revenues approved by state regulatory commissions. This direct concern of the FCC with the amount of intrastate revenues is prohibited by the Communications Act. The Communications Act was liberally modeled on the Interstate Commerce Act, which gave the Interstate Commerce Commission explicit authority to exercise the kind of authority which the FCC has attempted to exercise here. However, Congress explicitly rejected the alternative of giving the FCC the same authority it had given to the ICC. This is clear from comparisons between pertinent provisions of the Interstate Commerce Act and the Communications Act, and the legislative history of the Communications Act.

Second, even if the Communications Act is interpreted to give the FCC preemptive authority over accounting rules, that does not mean that the FCC may determine the intrastate rate impact of its accounting policies. By longstanding practice, accounting rules have been held not to determine ratemaking policy.

ARGUMENT

I. THE FCC MAY NOT PREEMPT STATE RATE-MAKING JURISDICTION BASED ON A FINDING THAT INTRASTATE REVENUE LEVELS ARE INADEQUATE TO EFFECTUATE ITS PURPOSES.

The FCC is not empowered to preempt state authority when its concern is simply that state revenues are inadequate to effectuate its policies. Congress could have given this power to the FCC, as it did to the Interstate Commerce Commission,[1] but it chose not to. A comparison between pertinent provisions of the Interstate Commerce Act and the Communications Act and the legislative history underlying 47 USC § 152(b)[2] make clear that Congress explicitly considered and rejected the alternative of giving the FCC the same pervasive preemptive authority it had given to the Interstate Commerce Commission for the regulation of the railroad industry.

A. Congress Expressly Gave the Interstate Commerce Commission the Authority to Override Intrastate Revenue Levels Prescribed by State Authorities to Ameliorate a National Crisis Caused by Deteriorating Rail Service.

The peculiar exigencies facing the railroad industry in the early twentieth century posed unusual challenges for Congress in fashioning regulatory policy. As this Court in *Railroad Commission of Wisconsin v. Chicago, Burlington and Quincy Railroad Company*, 257 U. S. 563 (1922) observed:

> Whatever the causes, the fact was that the carrying capacity of the railroads did not . . . develop proportionally with the growth of country, and it became difficult for them to secure additional investment of capital on feasible terms.

Id. at 582-3. To address this problem, the federal government took over control of the railroad industry in 1918. The Transportation Act of 1920[3] returned the industry to private control, but did so with a broad grant of preemptive authority to the Interstate Commerce Commission to permit it to deal effectively with the industry's precarious situation. Section 417 authorized the ICC to remove:

> Any undue or unreasonable advantage, preference as between persons or localities in intrastate commerce on the one hand and interstate or foreign commerce on the other hand, or any undue, unreasonable or un-

---

[1] 49 U.S.C. § 11501(a) reads as follows:

> The Interstate Commerce Commission shall prescribe the rate, classification, rule of practice for transportation or service provided by a carrier subject to the jurisdiction of the Commission . . . when the Commission finds that a rate, classification, rule or practice of a state causes:
>
> (1) between persons or locations in intrastate commerce and in interstate and foreign commerce, unreasonable discrimination against these persons or localities in interstate and foreign commerce; or
>
> (2) unreasonable discrimination against or imposes an unreasonable burden on interstate and foreign commerce.

[2] 47 U.S.C. § 152(b) reads, in part, as follows:

> Nothing in this Act shall be construed to apply or to give the Commission jurisdiction with respect to (1) charges, classifications, practices, services, facilities or regulations for or in connection with instrastate communication service by wire . . . of any carrier.

[3] 41 Stat. at L. 484 Ch. 91.

just discrimination against interstate and foreign commerce.[4]

The Supreme Court construed this language in the *Wisconsin* case observing:

> [T]he most novel and most important feature of the Act, requires the Commission so to prescribe rates as to enable the carriers as a whole, or in groups selected by the Commission, to earn an aggregate annual net railway operating income equal to a fair return on the aggregate value of railway property used in transportation.

Id. at 584. The Court rejected arguments that the language should be construed narrowly to apply only to the situation presented in *Houston East and West Railway Company v. United States,* 234 U. S. 342 (1914) (the *Shreveport Rate Case*). *Id.* at 587. In that case, this Court had upheld the ICC's authority to prescribe intrastate rates to prevent unjust discrimination between persons and localities. Distinguishing the issue presented in the *Wisconsin* case, the Court pointed out:

> [T]he effective operation of the Act will reasonably and justly require that intrastate traffic should pay a fair proportionate share of the cost of maintaining an adequate railroad system.

Id. at 586. Thus, the ICC was empowered to prescribe intrastate rates when it concluded that intrastate revenue levels were inadequate to maintain a viable national system.[5] It was exactly this pervasive authority over intrastate ratemaking that Congress sought to avoid in prescribing limitations to the authority of the Federal Communications Commission under 47 U.S.C. § 152(b).

[4] This provision, as amended, is now codified as 49 USC § 11501(a); *see* n. 1, *ante.*

[5] *Accord, New York v. United States,* 257 U.S. 591 (1922).

B. Congress Expressly Rejected the Alternative of Granting the FCC Broad Preemptive Authority Equivalent to That Granted to the ICC.

In his dissent below, Judge Widener recognized the broad reach of the Court's holding, stating that it has "effectively written 47 U.S.C. §§ 152(b) and 221(b) out of the Communications Act." 737 F.2d 398. This result is clear from comparisons between the pertinent provisions of the Interstate Commerce Act and the Communications Act and the legislative history of Section 152(b), both of which make clear that Congress did not intend to give the FCC the same preemptive authority it had given to the ICC. There was much discussion of this issue during congressional committee hearings.[6] In debate preceding passage of the bill, Senator Dill, the Senate Manager of the legislation, described the intended effect of the provision now codified as Section 152(b):

> We have attempted in Title II to reserve to the state commissions the control of intrastate telephone traffic. We have kept in mind the fact that the Interstate Commerce Commission, through the *Shreveport* decision *and decisions in other similar cases,* has gone so far in the regulation of the railroads that the so-called "state regulation" amounts to very little.

(*Emphasis Added*). 78 *Cong. Record* 8823 (1934).

[6] Hearings on S.2910 Before the Senate Committee on Interstate Commerce. 73d Cong. 2d Sess. 153, 155, 178, (1934) (Statements of Messrs. Clardy, McDonald and Benton); Hearings on H.R. 8301 before the House Committee on Interstate and Foreign Commerce, 73d Cong. 2d Sess. 70, 134 (1934), (Statements of Messrs. Benton and Clardy).

The decision in *Shreveport* made clear that the ICC could prescribe intrastate rates to prevent discrimination between persons or localities. The decision was based on a then effective provision of the Interstate Commerce Act prohibiting such discrimination[7] but making no mention of preemption over intrastate rates. Citing legislative history which made it clear that discriminatory practices were the principal evil the Interstate Commerce Act was intended to correct, the Court found that the ICC's responsibility to prevent such discriminations outweighed the autonomy states would otherwise have in setting intrastate railrates. As pointed out earlier, this authority was later made explicit and expanded upon, with a provision authorizing the ICC to override state regulatory authorities to prevent burdens on interstate commerce, in the Transportation Act of 1920.

Congress did not provide such expansive authority for the FCC in the Communications Act, however, despite its liberal use of the Interstate Commerce Act as a model for other provisions of the Communications Act.[8] It did

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[7] 24 Stat at L. 379, 380 ch. 104, sec. 3 provided as follows:

> That it shall be unlawful for any common carrier subject to the provisions of this act to make or give any undue or unreasonable preference or advantage to any particular person, company, firm, corporation, or locality, or any particular description of traffic, in any respect whatsoever, or to subject any particular person, company, firm, corporation, or locality, or any particular description of traffic, to any undue or unreasonable prejudice or disadvantage in any respect whatsoever.

[8] *See, e.g.*, 78 *Cong. Record* 8822 (1934), Statement of Senator Dill.

enact a section prohibiting unjust or unreasonable discrimination comparable to the provision of the Interstate Commerce Act reviewed in *Shreveport*.[9] However, it did not enact any provision which is at all comparable to the expanded authority of the ICC now codified as 49 U.S.C. 11501(a). Nowhere is the FCC given the authority to prescribe intrastate rates when it concludes that those authorized by state authorities create an unreasonable burden on interstate commerce.

Not only is such authority not provided, the statement of Senator Dill quoted earlier makes clear that it was not provided because Congress explicitly decided it did not want the FCC to have this authority. Senator Dill referred to *Shreveport* and decisions in other similar cases. *Shreveport* was given special mention, apparently, because it was a principal case and the first of a series of cases creating inroads into state regulatory authority over rail transport. However, the import of the Senator's statement is clearly provided by his reference to *Shreveport* and "decisions in other similar cases" which had gone "so far in the regulation or railroads that the so-called state regulation amounts to very little." He could only have been referring to cases construing the ICC's

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[9] 47 U.S.C. § 202 reads as follows:

> It shall be unlawful for any common carrier to make any unjust or unreasonable discrimination in charges, practices, classifications, regulations, facilities or services for or in connection with like communication service, directly or indirectly, by any means or device or to make or give any undue or unreasonable preference or advantage to any particular person, class of persons, or locality, or to subject any particular person, class of persons, or locality to any undue or unreasonable prejudice or disadvantage.

expanded powers under the Transportation Act of 1920. That statement, combined with the lack of any statutory provision giving the FCC authority equivalent to that of the ICC, despite Congress' use of the Interstate Commerce Act as a model, can only mean that Congress did not intend to give the FCC the authority to prescribe intrastate rates, or otherwise override revenue levels approved by state authorities when it simply concludes that such revenues are inadequate and potentially burdensome on interstate commerce. In making this judgment, Congress was aware that state regulatory commissions do not have unfettered jurisdiction to prescribe intrastate revenue levels, but must comply with state laws requiring just and reasonable rates as well as constitutional restrictions against confiscatory rates. Congress presumably found these safeguards to be adequate.

While national interests may justify incidental restrictions on state regulatory authority when necessary to effectuate a legitimate federal purpose, that interest must be focused on something other than adequacy of intrastate revenues alone. Otherwise, the situation would be identical to the approach chosen for railroad regulation. When no issue other than the adequacy of state revenues is presented, therefore, there is no basis for administrative preemption. That is precisely the situation presented in this case.

C. The FCC's Preemption Order was Based on the Concern that Revenue Levels Approved by the States were Inadequate to Effectuate its Purposes.

As the language of its Preemption Order makes clear, the FCC's principal concern was to ensure that national

carriers have adequate cash flow to compete effectively in what it perceived to be the evolving communications market. Its stated concern was that if telephone companies do not generate adequate revenues on their intrastate operations, they may be hampered in their efforts to compete nationally. In its Order, the FCC described depreciation as "a significant portion of the revenue requirement of regulated telephone companies" and continued:

> [T]he extent of state action attempting to prevent carriers from utilizing our depreciation prescriptions places substantial burden on carriers and could well impair their ability to fully compete in the continually evolving telecommunications market.[10]

The Fourth Circuit upheld the FCC, finding that "inconsistent state regulation poses an impediment to rapid development of interstate facilities." 737 F.2d at 396.

This direct concern with the adequacy of state revenues and the asserted effect of revenues viewed as inadequate distinguishes the exercise of administrative preemption in this case from all others which have preceded it. In *North Carolina Utilities Commission v. Federal Communications Commission*, 537 F.2d 787 (4th Cir. 1976) *cert. denied* 429 US 1027 (1976) and *North Carolina Utilities Commission v. Federal Communications Commission*, 552 F.2d 1036 (4th Cir. 1977) *cert. denied* 434 US 874 (1977), the Fourth Circuit upheld FCC preemption over the interconnection of customer provided equipment. These cases presented a classic confrontation where something had to give. Either customer provided equipment could

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10 Amendment of Part 31, Memorandum Opinion and Order, 92 FCC 2d 864 (January 6, 1983) Paragraph 37.

be connected to the dual intrastate and interstate network or it could not be. It could not be connected for purposes of interstate use only. Thus the standard of "physical impossibility" recognized by this Court in *Florida Avocado Growers, Inc. v. Paul,* 373 U.S. 132, 142-3 (1963), was found to be satisfied. The resolution of national supremacy in such a rare case of irreconcilable conflict provided no threat, however, to the underlying premise of concurrent state and federal jurisdiction.

In *Computer and Communications Industry Association v. Federal Communications Commission,* 693 F.2d 198 (D.C. Cir.) *cert. denied* 103 Sup. Ct. 2109 (1983) (*Computer II*), the issue was similarly circumscribed. There the D.C. Circuit upheld FCC preemption over the tariffing of new terminal equipment based on the FCC's conclusion that authority over jointly used facilities was necessary to effectuate its policies. In that case the FCC wanted a separate charge for customer premise equipment (CPE) which covered its costs so that customers would have an unfettered choice between utility supplied and competitor supplied CPE.

Obviously, if states reflected some of the cost of utility supplied CPE in intrastate rates, the unfettered choice the FCC intended customers to have could not exist. Customers choosing competitor supplied CPE would still be required to pay for part of the cost of utility-supplied CPE of other customers through their rates. Further, because part of the cost of utility supplied CPE would already be reflected in rates, the actual sale price could be below cost. As in the *North Carolina* cases, an irreconcilable conflict resulted. If the choice the FCC intended consumers to have were to exist, both federal and state policy

had to be consistent. As in the *North Carolina* cases, no serious threat to the underlying premise of concurrent jurisdiction resulted. Indeed, in both cases the impact on state jurisdiction was indirect, unavoidable, and no greater than necessary to effectuate the federal purpose. Further, the FCC did not attempt to increase intrastate revenues in any way and the federal interest in question bore no relationship to any issue concerning the adequacy of state revenues. In the *Computer II* case, the D.C. Circuit expressly recognized the barrier created by 152(b) and the legislative history underlying it, and justified the more narrow holding in that case by observing:

> In Computer II the Commission has neither attempted to set rates for interstate communications service or facilities nor asserted jurisdiction over matters of state concern because of interstate discrimination against interstate business.

693 F.2d at 216.

In contrast, given the FCC's stated concern that telephone companies require robust cash flows in order to compete effectively in the evolving telecommunications market, it is apparent that the approach taken in this case cannot be carefully circumscribed at all. What if the FCC later decides that liberalized depreciation policies alone are not adequate to permit telephone companies to compete effectively? What principle distinguishes depreciation expense from other components of the telephone companies intrastate revenue requirement, or the rates themselves, if the FCC concludes that further intrusion into intrastate ratemaking is required? In fact, there is none. The rationale offered by the FCC and upheld by the Fourth Circuit is an open ended license to influence

intrastate rate levels to the extent necessary to effectuate its policies.[11]

The FCC offers the additional rationale that depreciation policies are a principle determinant of the price of telephone service, and that improperly timed capital recovery can affect the demand for telephone service to the

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[11] GTE Service Corporation addresses this argument in its brief opposing the Petitions for Certiorari (See brief at 19-20). Describing concern about the broad impact of the precedent created by the Fourth Circuit's decision as based on "anxious hypotheticals," it goes on to assert without analysis that the "preemptive action at issue here was carefully limited." In fact, it offers no rationale for distinguishing depreciation expense from other elements of intrastate revenue requirements, promising only that any future exercise of preemption will be subjected to "careful scrutiny." Further, its discussion obfuscates the real import of the Fourth Circuit's decision by lumping together the two rationales offered by the FCC in support of its preemptive action: (1) that Congress intended preemption by giving the FCC authority to set depreciation rates and (2) the FCC may administratively preempt, even in the absence of express congressional intent, if it concludes that preemption is necessary to effectuate its policies. The Fourth Circuit upheld the FCC on the second rationale, finding it unnecessary to address the first. 737 F.2d at 392. GTE's sole suggestion as to why the precedent is limited is that:

> The ratemaking process is undisturbed at the state level except that, as Congress intended, the states may not deprive the FCC's depreciation prescriptions of practical effect.

(Brief at 20). This is not much of a limitation, since it would effectively derail state control over a vital element of intrastate ratemaking. In any event, this was not what the Fourth Circuit decided at all. It did not address the issue of explicit congressional preemption. It held that the FCC could administratively preempt state authority and influence intrastate revenue levels based on the view that "inconsistent state regulation poses an impediment to rapid development of interstate facilities." 737 F.2d at 396.

detriment of its procompetitive policies, and possibly even hinder the pace of technological advance. (Paragraph 34, 35, 37) This rationale simply cannot be viewed as relating to an incidental effect on intrastate ratemaking. The direct concern of the FCC with the level of the intrastate rates themselves is clear given its stated view that these rates must be at a certain level if its pro-competitive policies are to produce their most beneficial results. A more direct confrontation with the explicit direction of §152(b) could hardly be made.

Viewed more generally, the import of what the FCC is saying is that what it perceives to be improper price signals created by inconsistent state regulations are a burden on interstate commerce by conflicting with its procompetitive policies. However, as discussed above, Congress did not intend the FCC to prescribe or directly influence intrastate revenue levels or intrastate rates themselves to avoid what it perceives to be a burden on interstate commerce.

A further rationale which is alluded to in the Preemption Order but not developed is the concern that state depreciation policies may "ultimately threaten the carriers' ability to recover their invested capital." Paragraph 37. Even if that were true, carriers would have ample redress in state appellate courts because full recovery of invested capital is a fundamental principle of regulatory law. In *Democratic Central Committee of the District Court of Columbia v. Washington Metropolitan Transit Authority*, 485 F.2d 786 (1973), the D.C. Circuit, addressing the issue of depreciation under regulation, summarized this basic tenet:

> The process will eventually yield to investors the exact amount of their investment, and will ultimately cost consumers the same amount . . . But calculations, even of the highest predictive quality, sometimes go awry. Service life, productive life or salvage value may turn out to be more or less than originally estimated . . . Even when an asset is underdepreciated at the time it is retired from service, consumers must reimburse the investors therefor. And when utility property becomes unsuitable by reason of obsolescence before investors have fully recouped their investment in it, the loss is passed on to consumers.

Id. at 809-10.

Thus, if a case can be made that state depreciation policies threaten a carrier's entitlement to full capital recovery, rather than simply providing a different pace for the recovery of that capital, those policies would not meet the standard of "just and reasonable rates" under state law and would be viewed as confiscatory with respect to constitutional law. This result underscores the wisdom of Congress in relying on such legal requirements as a predicate to establishing its scheme of concurrent federal and state jurisdiction for the regulation of the communications industry. Policies at times may be inconsistent, one jurisdiction may at times be dissatisfied with the ratemaking decisions made in another jurisdiction, but established principles of regulatory law will still apply in both jurisdictions. There were other alternatives available to Congress in fashioning regulatory policy for the communications industry, including the more pervasive approach it chose for the railroad industry, but the choice Congress made is clear.

II. THE ACCOUNTING AND REPORTING REQUIREMENTS OF THE COMMUNICATIONS ACT DO NOT AUTHORIZE OR PERMIT THE FCC TO PREEMPT INTRASTATE RATEMAKING.

In deciding that it had the authority to preempt depreciation rates for intrastate plant, the FCC relied on the provisions of 47 U.S.C. § 220(b).[12] Even if this provision is viewed as preemptive, however, it provides accounting and not ratemaking authorization to the FCC. To uphold the FCC's construction of Section 220(b) would be to turn the ratemaking process on its head; ratemaking would be determined by accounting convention. Such a result is contrary to sound regulatory practice, the Communications Act and the Uniform System of Accounts (USOA) and has been rejected consistently by state and federal regulatory agencies and courts.

A. The Provisions of the Federal Communications Act and Uniform System of Accounts Setting Forth Reporting Requirements do not Dictate Ratemaking.

The FCC suggests that if the Communications Act or the USOA requires a particular reporting or accounting treatment for an item, that treatment is mandated for both inter and intrastate ratemaking purposes. The provisions of neither the Communications Act nor the USOA support such an interpretation.

The very first sentence of the Communications Act provides for the creation of the FCC "[f]or the purpose

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12 Amendment of Part 31, Memorandum Opinion and Order, 92 FCC 2d 864, 869 (1983).

of regulating ***interstate and foreign commerce in communication*** by wire and radio . . . ."[13] Consistent with that limited authorization, Congress precluded the FCC from exercising jurisdiction over ". . . charges, classifications, practices, services, facilities, or regulations for or in connection with intrastate communication service by wire or radio of any carrier . . . ."[14] or exchange service already subject to regulation by a state commission or local governing authority.[15] As a result of this dual system of regulation, the Communications Act specifically recognizes that separate sets of accounts, classifications and records may be required of carriers subject to state regulation.[16] Similarly, the Uniform System of Accounts authorizes carriers to keep special sets of accounts and books if required by state regulatory agencies.[17] If Congress intended federally-prescribed accounting treatment to be preemptive, each of these requirements would be meaningless.

The General Instructions to the USOA further demonstrate that the mandates of the Uniform System are nothing more than *reporting* obligations. Section 31.01-1 of the USOA states that "for accounting purposes" telephone companies are divided into Class A, B, C and D companies.[18] Pursuant to this scheme, Class A companies

[13] 47 U.S.C. § 151 (emphasis added).

[14] 47 U.S.C. § 152(b).

[15] 47 U.S.C. § 221(b).

[16] 47 U.S.C. § 410(b).

[17] *See, e.g.* 47 C.F.R. 31.01-2(f); 47 C.F.R. 33.12(d).

[18] 47 C.F.R. § 3101-1(a).

must keep *all* of the accounts prescribed by the USOA; Class B Companies all but those relating to operating revenues and expenses; Class C Companies all required by Part 33 of the USOA and Class D *none* of the accounts.[19] Furthermore, "[c]ompanies that desire more detailed accounting *may* adopt the accounts prescribed for a higher classification of telephone companies."[20]

If the construction adopted by the FCC and affirmed by the Fourth Circuit is permitted to stand, the result would be that as to certain classes of telephone companies FCC pronouncements have preemptive effect but as to others they do not. Whether preemption existed would be determined by the class (i.e. size) of the telephone company and would thus be unrelated to the FCC's goal of affording faster capital recovery to promote innovation and modernization, to allow carriers to effectively compete in the new telecommunications marketplace.[21] This result is both illogical and inconsistent with both the letter and the spirit of the Communications Act.

B. Agency and Judicial Precedent Establish that Federally Prescribed Accounting Procedures are not Determinative for Intrastate Ratemaking Purposes.

As discussed previously, neither the Communications Act nor the Uniform System of Accounts purport to dic-

[19] 47 C.F.R. § 31.01-1(b)-(e).

[20] 47 C.F.R. § 31.01-1(f) (emphasis added).

[21] Amendment of Part 31, Memorandum Opinion and Order, 92 FCC 2d 864, 877 (1983).

tate ratemaking treatment based on accounting convention. The decisions of both state and federal agencies and courts are in agreement. Therefore, the mere fact that the FCC has mandated a particular accounting treatment for certain expenses provides no independent ground for federal preemption of state ratemaking treatment of those items.[22]

As early as 1936, this Court recognized that an FCC requirement to keep accounts in a uniform fashion did not provide that agency with an independent basis to exercise jurisdiction over carriers not otherwise subject to its authority. The Court stated:

> The object of requiring such accounts to be kept in a uniform way, and to be open to the inspection of the Commission, is not to enable it to regulate the affairs of the corporations not within its jurisdiction, but to be informed concerning the business methods of the corporations subject to the act, that it may properly regulate such matters as are really within its jurisdiction.[23]

Since uniform reporting could not form an independent basis of jurisdiction, it could not dictate the ratemaking treatment of the items recorded in those uniform accounts.[24]

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[22] The distinction between ratemaking and accounting/reporting is discussed in the brief of the Louisiana, Ohio and Florida Public Service Commissions and *amici* adopt the positions set forth therein.

[23] *American Telephone & Telegraph Co. v. U.S.*, 299 U.S. 232, 237 (1936) (citations omitted).

[24] *See, e.g., Washington Public Int. Org. v. Public Service Com'n*, 393 A.2d 71, 80 (D.C. App. 1978), *cert. denied*, 444 U.S. 926 (1979).

In the landmark case of *Federal Power Commission v. Hope Natural Gas Co.*[25] Justice Jackson dissenting, warned of the dangers inherent in permitting accounting convention to dictate ratemaking policy:

> To make a fetish of mere accounting is to shield from examination the deeper causes, forces, movements, and conditions which should govern rates. Even as a recording of current transactions, bookkeeping is hardly an exact science. As a representation of the condition and trend of a business, it uses symbols of certainty to express values that actually are in constant flux . . . If one cannot rely on accountancy accurately to disclose past or current conditions of a business, the fallacy of using it as a sole guide to future price policy ought to be apparent. However, our quest for certitude is so ardent that we pay an irrational reverence to a technique which uses symbols of certainty, even though experience again and again warns us that they are delusive . . . .[26]

Adhering to this admonition, federal and state regulatory bodies, including the FCC and courts, have refused to permit accounting convention to mandate ratemaking treatment. Concerning the ratemaking treatment of char-

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[25] 320 U.S. 591 (1944).

[26] *Id.* at 643-44, n.40.

itable contributions,[27] plant under construction[28] disposition of utility property,[29] amortization of gains realized by requisitions,[30] nonproductive property,[31] donations, dues and lobbying expenses,[32] depreciation methodologies[33] and

27 *Re: Amendments of Part 31 of the Commission's Rules and Regulations,* 13 PUR3d 163, 168 (F.C.C. 1956) (proposed amendment to the USOA—"we do not intend that this document should be construed as setting forth any opinion concerning the rate-making aspects of the items at issue.")

28 *Washington Util. & Transp. Com'n v. Pacific N.W. Bell Tel. Co.* 26 PUR4th 495, 504 (Wash. Util. Transp. Com'n 1978) ("even if the proposed [USOA] rule change is approved by this commission for use by the respondent for reporting purposes—[the Commission] is not bound to utilize the same approach for rate-making purposes.")

29 *Washington Pub. Int. Org. v. Pub. Serv. Com'n,* 393 A.2d 71, 81 (D.C.C.A. 1978), *cert. denied,* 444 U.S. 926 (1979), ("accounting decisions, as such, could not be considered determinative for ratemaking itself . . . there is significant precedent demonstrating that circumstances will dictate ratemaking judgments independent of the uniform accounting system.")

30 *Consolidated Gas Supply Corp. v. FERC,* 653 F.2d 129, 135 (4th Cir. 1981) ("we first note that an item may be treated differently for accounting than for ratemaking purposes.")

31 *Re The Montana Power Company,* 42 PUR3d 241, 253 (Mont. Pub. Serv. Com'n, 1962) ("the regulatory body is not bound in its rate proceedings by any system of accounts it may have prescribed or by what is revealed in a review of the system of accounts.")

32 *Re Accounting Treatment for Donations, Dues, and Lobbying Expenditures,* 71 PUR3rd 440, 442 (N.Y. Pub. Serv. Com'n, 1967) ("commission's power in rate proceedings to recognize or disallow, as may seem reasonable and appropriate on the basis of the facts, certain expenditures either as to kind or magnitude, is not circumscribed by the accounting procedure.")

33 *Pacific Telephone & Telegraph Co. v. Pub. Utilities Com'n,* 401 P.2d 353, 373 (Cal. 1965) (state commission, "is not bound by the depreciation rates or methods set by the Federal Communications Commission.")

numerous other specific matters, regulatory agencies and the courts have consistently held that while the Uniform System of Accounts and accounting practices in general may be "valuable tools, they cannot dictate ratemaking policies."[34] In the face of this history, no valid reason exists to transform the reporting requirements of the Communications Act into a vehicle for the FCC to determine intrastate rates.

CONCLUSION

The judgment of the Court of Appeals for the Fourth Circuit should be reversed.

Respectfully submitted,

James E. Tierney
Attorney General of Maine
State House
Augusta, Maine 04330

Joseph G. Donahue,
General Counsel
Maine Public Utilities
Commission
242 State Street
Augusta, Maine 04333

Ray H. Walton
Commerce Counsel
North Dakota Public
Service Commission
State Capitol
Bismarck, North Dakota 58505

William E. Furber
Hayden and Furber
173 Park Row
Brunswick, Maine 04011

Counsel of Record

Robert A. Nelson
Chief Counsel
Montana Public Service
Commission
2701 Prospect Avenue
Helena, Montana 59620

Attorneys for the State of Maine and the Maine Public Utilities Commission

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34 *Alabama-Tennessee Natural Gas Co. v. Federal Power Com'n,* 359 F.2d 318, 336 (5th Cir. 1966).

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William C. Harrelson
General Counsel
Missouri Public Service Commission
P. O. Box 360
Truman State Office Building
Jefferson City, MO 65102

John E. Archibold
Special Assistant Attorney General
Public Utilities Commission of the State of Colorado
Logan Tower, Office Level 2
1580 Logan Street
Denver, Colorado 80203

Kirk J. Emge
General Counsel
Public Service Commission of Maryland
231 East Baltimore Street
Baltimore, Maryland 21202

Ellyn Elise Crutcher
Counsel
Kentucky Public Service Commission
730 Schenkel Lane
P. O. Box 615
Frankfort, KY 40602

Thomas Weis
General Counsel
Vermont Public Service Board
120 State Street
Montpelier, Vermont 04602

Mary L. Vanderpan
Assistant Attorney General
South Dakota Public Utilities Commission
Capitol Building
Pierre, South Dakota 57501

Georgia Public Service Commission
By: Michael J. Bowers
Attorney General
James O. Llewellyn
Senior Asst. Atty. General
Michael J. Henry
Asst. Atty. General
132 State Judicial Bldg.
Atlanta, GA 30334

Elizabeth Celis
Attorney, Legal Dept.
Arizona Corporation Commission
1200 W. Washington St.
Phoenix, Arizona 85007

Steven Clark
Attorney General of Arkansas
Justice Building
Little Rock, Arkansas 72203

John Doehm
Assistant Attorney General
Nebraska Public Service Commission
301 Centennial Mall South
Lincoln, NE 68509

Nos. 84-871, 84-889, 84-1054 and 84-1069

In the Supreme Court of the United States

OCTOBER TERM, 1985

LOUISIANA PUBLIC SERVICE COMMISSION,
Petitioner,

v.

FEDERAL COMMUNICATIONS COMMISSION
and UNITED STATES OF AMERICA, et al.,
Respondent.

(and three related cases)

ON WRIT OF CERTIORARI TO
THE UNITED STATES COURT OF
APPEALS FOR THE FOURTH CIRCUIT

MOTION FOR LEAVE TO FILE AND BRIEF OF THE TELEPHONE RATEPAYERS ASSOCIATION FOR COST-BASED AND EQUITABLE RATES AS AMICUS CURIAE IN SUPPORT OF PETITIONERS

MARK S. DODSON
JACK L. LANDAU *
LINDSAY, HART, NEIL & WEIGLER
111 S.W. Columbia, Suite 700
Portland, Oregon 97201
(503) 226-1191
Counsel for the Telephone Ratepayers Association for Cost-based and Equitable Rates

* Counsel of Record

STEVENS-NESS LAW PUB. CO., PORTLAND, OR. 97204 859

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**MOTION OF
THE TELEPHONE RATEPAYERS ASSOCIATION FOR
COST-BASED AND EQUITABLE RATES
FOR LEAVE TO FILE BRIEF AS AMICUS CURIAE**

The Telephone Ratepayers Association for Cost-based and Equitable Rates (TRACER) respectfully requests leave of the Court to file the attached brief as amicus curiae in support of petitioners.[1] As grounds for its motion, TRACER states as follows.

[1] Pursuant to Rule 42(2) of the Supreme Court Rules, TRACER has sought the consent of counsel for all parties. All parties save respondents, the North American Telephone Association and the United Telephone Company have consented.

1. TRACER is an unincorporated association of 27 business customers of local telephone companies regulated by the public service commissions of Oregon, Washington, Idaho and Nevada. Members of TRACER represent nearly every major segment of Pacific Northwest business, including local and interstate financial services, retail and commercial enterprises, manufacturing, large and small hospitals and local and regional governments. Collectively, TRACER members pay approximately $54 million each year for intrastate telecommunications services. Members of TRACER meet regularly to review current developments in the telecommunications industry, to exchange information on telecommunications issues and concerns and to evaluate the impacts of state and federal governmental initiatives concerning telecommunications. Where appropriate, TRACER has intervened in both state and federal regulatory proceedings, to provide regulatory agencies with information concerning the views of the business community on proposed telecommunications tariffs and policies, and to provide these agencies with independent analyses of the justifications for or the impacts of the proposals

2. In the case at bar, the lower court upheld the Federal Communications Commission's preemption of state prescription of depreciation rates used in setting intrastate telephone rates. In preempting state regulation of depreciation rates, the FCC ordered that all telephone companies be permitted to apply a method of accounting which results in more rapid capital recovery and, as a consequence, substantial rate increases for local telephone services.

3. The lower court's decision, if upheld, would produce substantial increases in telecommunications service rates for TRACER members. The rate increases will raise costs of production for TRACER members, producing higher prices for goods and services. Moreover, these rate increases will produce greater incentives for TRACER members to invest in alternative ("bypass") telecommunications systems, resulting in revenue losses to local telephone companies, loss of subscribership to the local network and deterioration of service quality to both residential and business customers.

4. TRACER is aware of no other party, intervenor, or amicus representing the interests of business ratepayers. TRACER has reason to believe that no other party to this proceeding will present arguments concerning the validity and impact of the lower court's decision in precisely the same manner as is set forth in the attached brief. In particular, TRACER knows of no other party that will present the impact of the FCC's preemption order on consumers, business or residential.

WHEREFORE, TRACER respectfully requests leave of the Court to file its brief as amicus curiae.

Respectfully submitted

MARK S. DODSON
JACK L. LANDAU *
LINDSAY, HART, NEIL & WEIGLER
111 S.W. Columbia, Suite 700
Portland, Oregon 97201
(503) 226-1191
Counsel for the Telephone Ratepayers Association for Cost-based and Equitable Rates

* Counsel of Record.

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MARK S. DODSON
JACK L. LANDAU *
LINDSAY, HART, NEIL & WEIGLER
111 S.W. Columbia, Suite 700
Portland, Oregon 97201
(503) 226-1191
Counsel for the Telephone Ratepayers Association for Cost-based and Equitable Rates

* Counsel of Record

September 9, 1985

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BRIEF OF THE TELEPHONE RATEPAYERS ASSOCIATION FOR COST-BASED AND EQUITABLE RATES AS AMICUS CURIAE IN SUPPORT OF PETITION

INTEREST OF AMICUS CURIAE

The interest of the Telephone Ratepayers Association for Cost-based and Equitable Rates (TRACER) as amicus curiae is set forth in the motion for leave to file that accompanies this brief.

SUMMARY OF ARGUMENT

Federal agency preemption is valid only if an agency can demonstrate that Congress "unmistakably . . . ordained" the preemptive action or that "the nature of the regulated subject matter permits no other conclusion." *Florida Lime and Avocado Growers, Inc.* v. *Paul*, 373 U.S. 132, 142 (1963).

The FCC's preemption of state depreciation regulation satisfies neither of these requirements. Congress did not expressly preempt state regulatory authority over depreciation rates in the Federal Communications Act, 47 U.S.C. § 151 *et seq.* Instead, it created a system of joint regulation by federal and state authority specifically designed to avoid excessive federal encroachment into areas of traditional state concern. 47 U.S.C. §§ 152(b), 220(b), 221(b).

Moreover, the nature of telecommunications regulation does not require federal preemption. Continued state regulation of depreciation presents no direct conflict with any lawful policy or objective of the FCC. Quite the opposite is the case. State regulation of depreciation is consistent with over forty years of FCC practice and comports with federal directives concerning the maintenance of an efficient nationwide network of telecommunications services. Federal preemption, on the other hand, conflicts with longstanding practice and threatens the very competitive telecommunications environment that the FCC has worked so long to foster.

For these reasons, the lower court's ruling approving the FCC's preemption of intrastate ratemaking should be reversed.

ARGUMENT

A. Introduction

At issue in this case is a 1983 Federal Communications Commission order requiring states to allow local telephone companies to use several specific methods of computing depreciation of telephone equipment and other investments. These methods, in large part, result in faster depreciation of telecommunications investments.[1] To support its preemption of what had been theretofore regulated by state regulatory commis-

[1] The primary method allowed by the FCC involved the "grouping" of investments (e.g. telephone poles, switches, cables) for the purpose of calculating service lives, the periods of time over which the costs of the investments can be recovered. Until the FCC's 1983 order, investments were grouped according to the year of installation and depreciated over the average service life of those investments, even though wide variations in actual service lives existed.

In its preemption order, the FCC allowed "equal life grouping." Under this method, investments are grouped according to their actual expected service lives, regardless of the year of installation. Smaller investment groups result, and theoretically, capital recovery better matches actual service lives.

On the average, the use of equal life grouping results in faster depreciation of investments, particularly if service lives are adjusted to reflect technological — as opposed to physical — obsolescence.

In its 1983 order, the FCC also allowed the use of the "remaining life" method to accommodate such adjustments. (footnote carried forward)

sions, the FCC relied on two theories. First, the agency argued that the Federal Communications Act, 47 U.S.C. § 151 *et seq.*, expressly authorized such preemption. *Amendment of Part 31*, 92 F.C.C.2d 864, 869 (1983). Second, it argued that if the states refused to allow the specific depreciation practices mandated, local telephone companies would fail to invest in new technology and competition in the interstate telecommunications marketplace would suffer. *Id.* at 876-77.

The Court of Appeals for the Fourth Circuit affirmed, albeit over a vigorous dissent. *Virginia State Corporation Commission* v. *Federal Communications Commission*, 737 F.2d 388 (4th Cir. 1984). In upholding the FCC's preemptive order, however, the lower court misapplied longstanding precedent governing preemption of state authority by federal agencies.

Settled principles of constitutional law require federal agencies to satisfy stringent requirements before they may preempt state regulatory authority. This is particularly true in the case of federal regulation of trade and commerce. As the Court recently stated in *Hayfield Northern Railroad Company* v. *Chicago and Northwestern Transportation Company*, — U.S. —, 52

(footnote continued)

Under this method, a company may simply allocate any unrecovered depreciation over the remaining adjusted service life of the investment. Again, if the adjustments are made to reflect technological obsolescence, depreciation tends to be substantially accelerated under this method. *See generally Amendment of Part 31*, 83 F.C.C.2d 267 (1980).

U.S.L.W. 4783, 4786 (June 12, 1984), "federal regulation in a field of commerce should not be deemed preemptive of state regulatory power in the absence of persuasive reasons — either that the nature of the regulated subject matter permits no other conclusion or that Congress has unmistakably so ordained." (quoting *Florida Lime and Avocado Growers, Inc.* v. *Paul*, 373 U.S. 132, 142 (1963)). *See also Fidelity Federal Savings & Loan Association* v. *de la Cuesta*, 458 U.S. 141, 153 (1982).

Whether Congress has "unmistakably . . . ordained" federal preemption is ultimately a question of congressional intent, which may be explicitly stated in a "statute's language or implicitly contained in its structure and purpose." *Jones* v. *Rath Packing Co.*, 430 U.S. 519, 525 (1977).

Whether "the nature of the regulated subject matter permits no other conclusion" may be determined by the existence of direct conflicts with federal law, either when "compliance with both federal and state regulations is a physical impossibility," *Florida Lime*, 373 U.S. at 142-43, or when state law "stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress." *Hines* v. *Davidowitz*, 312 U.S. 52, 67 (1941); *see also de la Cuesta*, 458 U.S. at 153.

The FCC's preemption of intrastate ratemaking fails to satisfy these essential qualifications for valid federal agency preemption. Congress has not unmis-

takably ordained that the FCC must preempt state authority over telephone rates. Neither does the existence of differing state depreciation ratemaking practices conflict with any of the FCC's statutory purposes or objectives. There being no valid reason for the FCC to exercise such extraordinary preemptive authority, the lower court's decision upholding the FCC's preemption order should be reversed.

B. Congress Has Not "Unmistakably Ordained" That State Ratemaking Authority Should Be Preempted.

Nothing in the Federal Communications Act, 47 U.S.C. § 151 *et seq.*, evinces unmistakable congressional intent that state regulators should not be allowed to fashion telephone rates to reflect the needs and conditions of their own jurisdictions. On the contrary, careful scrutiny of the Act and its legislative history reveals that Congress created a system of shared authority to be jointly exercised by the FCC and the states.

The Act does give the FCC certain powers to set depreciation charges.[2] However, section 152(b) also

[2] Section 220(b) states that

> The Commission shall, as soon as practicable, prescribe for such carriers the classes of property for which depreciation charges may be properly included under operating expenses, and the percentages of depreciation which shall be charged with respect to each of such classes of property, classifying the carriers as it may deem proper for this purpose.

47 U.S.C. § 220(b).

expressly reserves for the states authority to regulate intrastate telecommunications services:

> [N]othing in this chapter shall be construed to apply or to give the Commission jurisdiction with respect to (1) charges, classifications, practices, services, facilities, or regulations for or in connection with intrastate communication service . . .

47 U.S.C. § 152(b). Similarly, section 221(b) provides that the FCC's jurisdiction cannot infringe upon "matters . . . subject to regulation by a state commission or by local government authority." 47 U.S.C. § 221(b). Thus it is clear from the language of the Act itself that the FCC was not intended to be the sole arbiter of telecommunications service charges and classifications. This authority was intended to be shared.

The legislative history of the Communications Act illuminates Congress's intent to limit FCC incursions into state ratemaking practices. Prior to passage of the 1934 legislation, the Supreme Court had authorized the Interstate Commerce Commission to set intrastate railroad rates to avoid discrimination between state and federal rates. *Houston, East & West Texas Railway Co.* v. *United States*, 234 U.S. 342, 358-59 (1914) (the "*Shreveport Rate Case*"). Concerned about this extraordinary grant of federal agency authority, Congress crafted the Communications Act to preserve shared federal and state responsibility for regulating telecommunications rates and charges. In the 1934 Senate Committee hearings, for example, the chairman of the Interstate Commerce Committee plainly stated

that the Committee's legislation was written "to protect the state commissions against being overridden by this Commission, as the Interstate Commerce Commission has overridden some of the railroad state commissions." *Hearings on S. 2910 before the Senate Interstate Commerce Committee*, 73rd Cong., 2d Sess. 179 (1934) (Statement of Senator Dill). *See also North Carolina Utilities Commission* v. *Federal Communications Commission*, 552 F.2d 1036, 1047 (4th Cir. 1977) ("[I]n enacting the Communications Act, Congress sought to deny the FCC the kind of jurisdiction over local rates approved by the *Shreveport Rate Case*.").

For over forty years the FCC exercised its authority consistent with this principle of shared jurisdiction. Indeed, as late as eight months prior to the preemption order at issue in this case, the agency commented that the language of the Communications Act indicated that

> the 1934 Congress wished to achieve as much uniformity as possible without coercing any state commission to use ratemaking methods it found acceptable. This commission has proceeded in a manner that is consistent with that purpose for nearly four decades. We have always given special consideration to the needs and views of State commissions in developing accounting and depreciation rules and most State commissions have chosen to follow most accounting and depreciation rules prescribed by this commission. Departures have nonetheless occurred from time to time.

> This Commission has never attempted to prevent any State commission from departing from our accounting and depreciation rules. *Indeed, we have expressly recognized that State commissions have a right to do so.*

Amendment of Part 31, 89 F.C.C.2d 1094, 1106-07 (1982) (emphasis added).[3]

To say that Congress has "unmistakably ordained" federal preemption of state depreciation ratemaking does unconscionable violence to the explicit language of the Federal Communications Act, its legislative history, and over forty years of consistent, uninterrupted interpretation by the FCC itself. The lower court's approval of the FCC's preemption order should be reversed and the states restored their statutory and historical right to set local telephone rates.

C. State Regulation of Local Depreciation Rates Does Not Directly Conflict With The Purposes And Objectives of Lawful Federal Communications Regulation.

Only when there is a direct conflict with federal authority can an agency of the federal government

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[3] In the same order, the FCC further observed that to preempt state depreciation regulation would

> repudiate nearly forty years of administrative practice and applicable state court proceedings by adopting an interpretation of Section 220 that would require an unwilling state commission to follow all accounting and depreciation methods prescribed by this Commission. A very compelling showing would be required to persuade us to follow such a course.

Amendment of Part 31, 89 F.C.C.2d at 1107.

presume upon the jurisdiction of the states. State law must do " 'major damage' to 'clear and substantial' federal interests before the Supremacy Clause will demand that state law be overridden." *Hisquierdo* v. *Hisquierdo*, 439 U.S. 572, 581 (1979) (quoting *United States* v. *Yazell*, 382 U.S. 341, 352 (1966)). Mere theoretical inconsistencies will not suffice. *Hayfield*, 52 U.S.L.W. at 4786.

No conflict with federal interests exists here. Absolutely nothing in any of the FCC's recent orders concerning depreciation ratemaking demonstrates that state and federal regulation of telephone depreciation practices cannot lawfully co-exist.

According to the FCC, preemption is necessary to ensure that improper capital recovery at the local level does not frustrate investment in developing technology and thus impede an interstate carrier's ability to compete with new entrants in the interstate marketplace.[4] And competition, the FCC has determined, is the optimum method of fulfilling its statutory responsibility to provide a "rapid, efficient, nationwide, and world-wide" communications network. *Amendment of Part 31*, 92 F.C.C.2d at 876-877.

It may be true that local depreciation practices

[4] According to the FCC, failure to allow equal life group and remaining life methods could hamper carriers' ability to raise sufficient capital to invest in more modern equipment, needed "to fully compete in the continually evolving competitive telecommunications marketplace." *Amendment of Part 31*, 92 F.C.C.2d at 877.

have some effect on the extent to which local exchange companies upgrade telephone plant and invest in new technology. But the connection between technological advances at the local level and the existence of competition on an interstate basis is all but impossible to discern.

The problem with the FCC's argument is that it ignores the fact that local exchange companies are required to provide access to competing carriers on an equal basis. *United States* v. *American Telephone and Telegraph Company*, 552 F. Supp. 131, 196 (D.D.C. 1982), *aff'd*, — U.S. —, 103 S. Ct. 1240 (1983). This is true regardless of the local companies' depreciation practices or the technologies in which they choose to invest.

If, for instance, a local telephone company is required to use a less detailed form of depreciation and it is unable to finance the purchase of new switching technology, interstate carrier competition is not affected in the least. Each interstate carrier connects its transmission lines to the very same local switching equipment. None is given a competitive advantage over the other.

Likewise, if the FCC-mandated depreciation methods are adopted and the local company is able to finance the purchase of the latest digital electronic switching systems, the result is exactly the same. The interstate carriers have access to the identical technology. Their ability to compete with one another re-

mains unaffected. In short, whether a state chooses to allow one method of depreciation or another, its decision will have no impact on the relative competitive positions of interstate carries whatsoever. [5]

If state regulation of depreciation charges has any impact on competition in the telecommunications markets at all, it is on intrastate markets alone. Fostering competition within purely intrastate markets is, however, beyond the express statutory authority of the FCC. 47 U.S.C. § 152(b). Even under the agency's own interpretation of the Act, the FCC would not have the authority to preëmpt state regulatory authority in order to pursue a policy of developing intrastate competition. *See* Motion to Dismiss and Brief for the Federal Respondents in Opposition at 15 (section 152(b) "preserves state authority over purely intrastate matters . . .").

This is as it should be, for the states are in the best position to evaluate local market conditions, cus-

[5] In his dissent from the lower court's affirmance of the FCC's depreciation order, Judge Widener expressed similar skepticism at the agency's argument:

> I cannot see how nonconforming depreciation methods for the carriers' intrastate operations can frustrate competition in the interstate communications markets within which there is competition. The only rationale I can find for the FCC's position is that the States, if not required to follow the FCC's lead, will allow the carriers less revenue . . .

Virginia State Corporation Commission v. *Federal Communications Commission*, 737 F.2d 388, 398 (Widener, dissenting).

tomer demands and other economic realities that bear upon the appropriateness of varying regulatory approaches to the telecommunications industry. In some areas of Eastern Oregon and Washington and Northern Idaho, for example, competition for telecommunications services of any sort is virtually non-existent. In contrast, major metropolitan areas such as Seattle and Portland experience burgeoning competition for a variety of telecommunications services. A federal agency is simply not equipped with the information necessary to develop a system of telecommunications regulation that best suits the needs of local ratepayers.

And the states are facing up to their task. The FCC has not stepped in to fill a regulatory void. In the Pacific Northwest, the legislatures of Oregon and Washington have this last year enacted sweeping new laws that allow state regulatory authorities to regulate, deregulate, or detariff telecommunications services to meet current market conditions. The Public Utilities Commission of Idaho is currently evaluating appropriate standards to be used in determining when the public interest would be served by relaxed forms of telephone company regulation. Similarly, the Nevada Public Service Commission has recently initiated a rulemaking proceeding to determine the extent to which intrastate competition exists in that area and how it should be regulated. Thus, not only is FCC interference with state ratemaking authority illegal, it is unnecessary.

Even if the FCC were correct in asserting that state depreciation regulation directly affects interstate competition, closer scrutiny of the facts discloses that the ultimate affect is exactly the opposite of what the FCC supposes. Rather than present a conflict with lawful federal objectives, state depreciation regulation is perfectly consistent with the FCC's competitive objectives. It is the federal preemption of depreciation ratemaking that will frustrate the creation of competitive markets.

To achieve the goal of engendering a dynamic, competitive telecommunications marketplace, the FCC has required that states authorize telephone companies to use depreciation methods that accelerate the recovery of investments in telephone plant. Using the accelerated recovery methods, however, necessarily produces sizeable rate increases for ratepayers. [6] The FCC's own estimates of the impact of its preemption order total over $2 billion for 1984 alone. W. Bolter, *Telecommunications Policy for the 1980s: The Transition to Competition* 166 (1984). In a single South Central Bell rate case, the FCC's required depreciation practices produced rate increases totaling

[6] According to basic principles of public utility ratemaking, each year a telephone company deducts the allowable sum for depreciation from its rate base and charges the sum as an operating expense, that is, as a direct addition to the company's revenue requirement. *See generally* C. Phillips, *The Regulation of Public Utilities* 250-57 (1984). Thus, if the company is allowed to depreciate a greater sum over a shorter period of time, larger revenue requirements result.

over $60 million. *See* Jurisdictional Statement of Louisiana Public Service Commission at 16. [7]

It is hard to imagine how such increases in consumer rates would make the regulated telephone companies better equipped to deal with growing competition. Basic economics and actual experience indicate that such increases in telecommunications service rates provide high-volume business customers with significant incentives to bypass local networks, resulting in still higher rates as fewer customers are left to pay for the largely fixed costs of the system. [8] If anything, the FCC's preemption of state depreciation ratemaking will itself thwart the development of competition. [9]

[7] The so-called Ernst Report, "Study of Depreciation Rate Practices and Policies," prepared for the FCC in its original evaluation of depreciation practices, conceded that the use of depreciation procedures ultimately mandated by the agency "would result in increases in revenue requirements initially, and possibly over the longer term . . ." *Amendment of Part 31*, 83 F.C.C.2d 267, 279 (1980). The Ernst Report also added that the use of this methodology "would result in an increased regulatory burden and consequently, increased regulatory staffs." *Id.*

[8] Pacific Northwest Bell estimates that from local ("intra-LATA") bypass alone, it faces a potential revenue loss of over $44 million. Pacific Northwest Bell, *Bypass Analysis* 30 (May 16, 1984). Rate increases required to cover increased depreciation expenses can only serve to increase the amount at risk.

[9] The fact that the FCC believes that local exchanges can withstand the price increases also belies the agency's unsubstantiated conclusion that competition even exists on a widespread basis. Any effort at accelerating capital recovery requires captive — monopoly — ratepayers that can tolerate

Even worse, federal preemption of depreciation ratemaking will lead to inefficient and costly over-investment, producing systems top-heavy with esoteric technology of little use to most subscribers. It is no coincidence that Pacific Northwest Bell — during the most recent depreciation ratesetting proceeding — announced its plans to invest in 145 state-of-the-art electronic digital switching systems, to be installed in predominantly rural areas of Western Washington and Oregon at a total cost of $102 million. The benefits to a competitive telecommunications market are dubious at best. But the impact on telephone service rates will be unmistakable. [10]

(Footnote continued)

the increases. Otherwise, customers would seek alternative providers not burdened with the costly problem of speeding up plant turnover. See Trebing, *A Critique of Structure Regulation in Common Carrier Telecommunications*, in Telecommunications Regulation Today and Tomorrow (E. Noam ed. 1983) 145-46.

[10] TRACER is certainly aware that its members — many of whom are large, high volume business customers — stand to benefit from the installation of efficient, up-to-date network equipment. However, the specific demands of these customers, the threat of bypass, market conditions, and other factors with which state regulators are routinely familiar, are more than adequate to ensure timely upgrading of plant quality. The FCC's unwarranted penchant for national uniformity merely encourages local companies in all areas to rapidly convert their networks, whether customers would benefit or not, all at great expense to business and residential ratepayers, large users and small.

CONCLUSION

The Federal Communications Commission's preemption of state depreciation regulation is illegal and unnecessary. It is supported by neither the language of the Communications Act, the legislative history, nor sound ratemaking policy. In approving the FCC's preemption order the lower court erred, departing from a long line of authorities on the requirements of valid federal agency preemption.

For the foregoing reasons, TRACER as amicus curiae urges the Court to reverse the judgment of the court below.

Respectfully submitted

MARK S. DODSON
JACK L. LANDAU *
LINDSAY, HART, NEIL & WEIGLER
111 S.W. Columbia, Suite 700
Portland, Oregon 97201
(503) 226-1191
Counsel for the Telephone Ratepayers Association for Cost-based and Equitable Rates

* Counsel of Record.

Nos. 84-871, 84-889, 84-1054 and 84-1069

IN THE

Supreme Court of the United States

OCTOBER TERM, 1985

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On Appeal and on Petitions for a Writ of Certiorari to the United States Court of Appeals for the Fourth Circuit

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BRIEF OF THE NATIONAL CONFERENCE OF STATE LEGISLATURES, THE NATIONAL GOVERNORS' ASSOCIATION, THE COUNCIL OF STATE GOVERNMENTS, THE NATIONAL LEAGUE OF CITIES, THE NATIONAL ASSOCIATION OF COUNTIES, THE U.S. CONFERENCE OF MAYORS, AND THE INTERNATIONAL CITY MANAGEMENT ASSOCIATION AS *AMICI CURIAE* IN SUPPORT OF PETITIONERS

BENNA RUTH SOLOMON
Chief Counsel
JOYCE HOLMES BENJAMIN *
THE STATE AND LOCAL LEGAL CENTER
444 North Capitol Street, N.W.
Suite 349
Washington, D.C. 20001
(202) 638-1445
* *Counsel of Record for the Amici Curiae*

QUESTION PRESENTED

Did Congress, in the Federal Communications Act, grant the Federal Communications Commission the authority to order state regulatory agencies to use interstate depreciation practices in setting *intrastate* telephone rates?

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INTEREST OF *AMICI*

The *amici* are organizations whose members include state, county, and municipal governments and officials throughout the United States. *Amici* and their members have a vital interest in legal issues that affect the powers and responsibilities of state and local governments.

The court below upheld the primacy of Federal Communications Commission (FCC) regulation of interstate depreciation over state authority to regulate *intrastate* [1] rates. The FCC's decision to promote the financial interests of the communications industry strips state governments of their statutory power to oversee the state regulated non-competitive *intrastate* public communications business. The court below accepted the agency's conclusion that the "efficiency of the national communications network" is at stake. It dismissed as less important the expressed Congressional intent to preserve state regulation in this area, which has been committed to state governance by tradition as well as by statute. Such reasoning renders state regulation in any area touching on national concerns vulnerable to preemptive action by federal regulatory agencies without regard to the will of Congress and the safeguards of the political process.

[1] Throughout this brief, the word "intrastate" is italicized to facilitate its distinction from the similarly spelled word "interstate."

This Court has frequently made it plain that only Congress can authorize federal agencies to extend their regulatory sway so as to preempt state rules. If the decision below is upheld, it will have a dramatic adverse effect on the ability of states to regulate local affairs in the public interest.

For these reasons, the case is of great importance to *amici* and their members, and we are submitting this brief to aid the Court in its consideration.

STATEMENT OF THE CASE AND INTRODUCTION

Amici agree with the statement of facts submitted to this Court by petitioners California and the Public Utilities Commission of California.

This case presents a fundamental question of federal preemption by agency action in an area of established state authority. The issue is not whether the FCC acted rationally or with sufficient expertise in setting depreciation rates. Rather, the issue is whether the FCC had the power under the Federal Communications Act of 1934 to preempt the states' long-standing authority to regulate *intrastate* telephone rates. Consequently, it is of grave concern to all state and local governments.[2]

We believe that this issue is best understood in light of the historical background of the Federal Communications Act, 47 U.S.C. §§ 151 *et seq.*, (hereinafter the Act).[3] In

[2] State interest in the immediate problem presented in this case is demonstrated by the fact that about half the states are involved in these related cases as parties or intervenors. Not only these states but all states and local governments are affected by the sweep of the Fourth Circuit's opinion, *Virginia State Corporation Comm'n v. FCC*, 737 F.2d 388 (4th Cir. 1984), which encourages agency preemption despite express language preserving state authority.

[3] *See* S. Rep. No. 781, 73d Cong., 2d Sess. (1934); Attorney General's Comm. on Administrative Procedure, *Administrative Procedure in Government Agencies*, Part 3, Federal Communications

1934, when the Act was passed, the telecommunications industry was already regulated by both federal and state governments. The states had regulated the *intrastate* telecommunication industry for many years.[4] Congress acted to consolidate the fragmented federal administrative structure which regulated the interstate aspects of the industry through the Interstate Commerce Commission and the Federal Radio Commission. Congress deliberately chose not to extend federal regulation to *intrastate* services.

As this Court had recognized, separation of *intrastate* and interstate property, revenues and expenses under the system existing at the time was not simply a "theoretical allocation" between interstate and *intrastate* service but "essential to the appropriate recognition of the competent governmental authority in each field of regulation." *Smith v. Illinois Bell Telephone Co.*, 282 U.S. 133, 148 (1930).

In the Act, Congress consciously preserved the existing system of dual regulation. Congress wished to avoid subjecting *intrastate* communications to the sort of federal preemption that had occurred in the railway industry. While the Interstate Commerce Commission may have had jurisdiction to set depreciation schedules for telephone companies under the Interstate Commerce Act, the Commission had not exercised such authority at the time

Commission, App. A, Historical Background of the Communications Act of 1934 (1940). Federal regulation of telegraph service began with the Post Roads Act of 1866, 14 Stat. 189 (1866). In 1910 the Mann-Elkins Act, 36 Stat. 540 (1910), granted the Interstate Commerce Commission regulatory jurisdiction over interstate and foreign telegraph, telephone and cable service. The Radio Act of 1927, 44 Stat. 1162 (1927), established the Federal Radio Commission to regulate the broadcast industry.

[4] Jones, *Origin of the Certificate of Public Convenience and Necessity: Development in the States, 1870-1920,* 79 Col. L. Rev. 426 (1979).

the Federal Communications Act was adopted.[5] The Congressional Committees considering the bills were well aware that the Interstate Commerce Commission was considering the adoption of depreciation rates for telephone companies.[6] The bill was written to continue the powers which the Interstate Commerce Commission and the Radio Commission "*now exercise*[*s*] over communications, by means of definite statutory provisions," (emphasis added) so that the new Communications Commission would not be "in doubt as to its powers by reference to general legislation primarily designed for railroads."[7] In fact, the Senate Committee on Interstate Commerce deliberately chose not to incorporate into the bill the regulatory practices of the Commission which the Committee viewed as having eroded state regulation.[8]

Congress' intention to preserve dual rate regulation was honored by the FCC for more than forty years. Until it adopted the order challenged in this case, the FCC had never preempted state regulation of depreciation schedules for *intrastate* rate setting purposes. In fact, "[t]his Commission has never attempted to prevent any State commission from departing from our accounting and depreciation rules" but has "expressly recognized that

[5] *Northwestern Bell Telephone Co. v. Nebraska State Railway Comm'n*, 297 U.S. 471 (1936). The Court refused to decide the effect upon state power of federally established depreciation rates as the ICC had taken no action to establish them.

[6] *Id.* at 477-478.

[7] S. Rep. No. 781, 73d Cong., 2d Sess. 2 (1934).

[8] "We have kept in mind the fact that the Interstate Commerce Commission, through the Shreveport decision and the decisions in other similar cases, has gone so far in the regulation of railroads that the so-called 'State regulation' amounts to very little." 78 Cong. Rec. 8823 (1934). In *Houston, East & West Texas Railway Co. v. United States*, 234 U.S. 342 (1914), this Court held that the Interstate Commerce Commission had the authority to control *intrastate* rail rates to prevent discrimination against interstate commerce.

State commissions have a right to do so." [9] The change announced in the FCC's January 1983 order, preempting the states' authority to set their own depreciation rates, is, therefore, an abrupt departure from previous practice.[10]

SUMMARY OF ARGUMENT

1. Congress premised the Federal Communications Act on a system of dual regulation. The states were to continue their jurisdiction over *intrastate* "charges, classifications, practices, services, facilities and regulations." 47 U.S.C. § 152(b). The Act was intended to regulate interstate and foreign communications. Nothing in the Act gives the FCC authority to regulate *intrastate* communications or to control depreciation rates to be used in calculating charges for *intrastate* service. The ordinary meaning of the language employed by Congress and the legislative history of the Act refute the claim that Congress intended to preempt state ratesetting.

The decision below virtually ignores Congressional intent and looks instead to the intent of the federal agency charged with administering the Act. An agency, however, must act within the scope of the authority granted it by Congress, and may not interpret that authority so expansively as to read out of the act Congress' own policy choice to preserve state regulation.

2. Furthermore, an intent by Congress to preempt state regulation of *intrastate* depreciation cannot be inferred from the purpose of the Act. The purpose is a general one addressed to the nationwide concern of controlling the interstate aspects of communication. Congress clearly had the power to preempt *intrastate* regulation of communications service, but chose not to do so. State laws regulating *intrastate* rates offer no obstacle to the accomplishment of the federal purpose, nor do they conflict with federal law.

Whatever effect state prescribed depreciation practices have on the capital return of the interstate communication companies, whether "attenuated" or "substantial," that effect cannot justify ignoring the expressed policy choice of Congress. Appellees argue that the FCC order affects only a "single element" in the ratemaking formula. Simple arithmetic makes plain that changing any factor in a formula changes the result.

3. If the FCC and the interstate industry wish to change the law, the request should be addressed to Congress. The FCC was not delegated unrestrained authority by Congress. If it wishes to enlarge the scope of that authority, its remedy is to report to Congress and ask that the Act be amended "to define further or harmonize the powers of the Commission and of State commissions" (47 U.S.C. § 220(j)).

The scope of federal regulation is the stuff of politics. Setting its limits is inherently a political decision which should be left to the Congress where the political process can operate to protect states against the enactment of unduly burdensome laws.

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[9] *In re Amendment of Part 31,* 89 F.C.C.2d 1094, 1106-1107 (1982); P. App. 82 (References in this form are to the Appendix to the Petition for Certiorari filed by California.)

[10] This departure from former practice may have been caused by the newly deregulated status of the telephone industry. The national monopoly in the telephone industry ceased to exist in 1984 following AT&T divestiture.

ARGUMENT

I. THE FEDERAL COMMUNICATIONS ACT EXPRESSLY PRESERVES TRADITIONAL STATE AUTHORITY TO REGULATE TELEPHONE RATES.

In any preemption analysis, the first question is whether Congress intended to preempt the state regulation in question. "The purpose of Congress is the ultimate touchstone." *Malone v. White Motor Corp.*, 435 U.S. 497, 504 (1978). The preemption doctrine, which is derived from the Supremacy Clause, looks first to the expression of Congress found in the Act itself. "[W]e have no choice but to 'begin with the language employed by Congress and the assumption that the ordinary meaning of that language accurately expresses the legislative purpose.'" *Metropolitan Life Insurance Co. v. Massachusetts*, —— U.S. ——, 105 S.Ct. 2380, 2389 (1985), citing *Park 'n Fly, Inc. v. Dollar Park and Fly, Inc.*, —— U.S. —— (1985) (slip. op. 4). *American Textile Manufacturers Institute, Inc. v. Donovan,* 452 U.S. 490, 508 (1981).

The stated purpose of the Federal Communications Act is to regulate "interstate and foreign commerce in communication," to make available to all the people of the United States "a rapid, efficient, Nation-wide, and world-wide wire and radio communication service with adequate facilities at reasonable charges." 47 U.S.C. § 151. This task is to be accomplished "by centralizing authority heretofore granted by law to several agencies" and "by granting additional authority with respect to interstate and foreign commerce."

Section 152(a) makes the Act applicable to "all interstate and foreign communication by wire or radio" but is followed immediately by section 152(b), which explicitly exempts *intrastate* commerce from its scope:

> "[N]othing in this chapter shall be construed to apply or to give the Commission jurisdiction with respect to (1) charges, classifications, practices, services, facilities, or regulations for or in connection with intrastate communication service by wire or radio of any carrier . . . ." 47 U.S.C. § 152(b).

The ordinary meaning of the foregoing language plainly reserves to the states authority to regulate the *intrastate* telecommunications industry.

Not only section 152(b) but the entire act embodies the concept of dual regulation. Section 220(b) gives the FCC authority to set depreciation rates—but only for interstate carriers. The statute makes that plain. Section 220(b) says the Commission shall "prescribe for *such* carriers" (emphasis added) the classes of property which may be depreciated and the depreciation rates. "Such carriers" are defined in section 220(a) as "carriers subject to this chapter," *i.e.*, persons engaged in "interstate or foreign communication" (Section 153(h)). Moreover, section 220(h) allows the FCC to classify "carriers", *i.e.*, interstate carriers, and, if consistent with the public interest, to except "carriers" from the act in cases where they are subject to a state commission. *Intrastate* communications and carriers are not defined in the Act for the obvious reason that Congress did not intend to sweep their regulation into the scope of the FCC's jurisdiction.

The common sense view of the matter is that Congress meant what it said and said what it meant—that "nothing in this chapter" gave the FCC jurisdiction over *intrastate* rates.

A dual regulatory system offered many advantages to Congress. It allowed each state to make policy choices affecting local interests, reduced the regulatory burden on the federal government, and reinforced the principles

of federalism and political pluralism on which this country was founded.[11]

If Congress had wished to mandate a uniform national system for the telecommunication industry, it knew how to do so. Numerous statutes unequivocally reserve certain activities to the Federal government.[12] The Congress could simply have made "the power, jurisdiction, and authority" of the FCC "exclusive with respect to all persons" licensed under the Act. *Rice v. Santa Fe Elevator Corp.*, 331 U.S. 218, 233 (1947). Whatever the merits of exclusive federal control, Congress made the policy choice to reject it, and to retain the existing system of dual regulation.

The decision below relies heavily on the general purpose language of the Communications Act which "places primary emphasis upon a rapid, efficient, Nationwide, and world-wide" communication service and finds that concern overriding.[13] But ordinary rules of statutory construction do not allow the effective excision of other sections of the statute. All sections must be read and, if possible, harmonized and followed.[14]

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[11] One great advantage of retaining a dual regulatory system was expressed by Justice Brandeis in his dissent in *New State Ice Co. v. Liebman*:

> There must be power in the states and the nation to remould, through experimentation, our economic practices and institutions to meet changing social and economic needs . . . . It is one of the happy incidents of the federal system that a single courageous state may, if its citizens choose, serve as a laboratory; and try novel social and economic experiments without risk to the rest of the country. 285 U.S. 262, 311 (1932).

[12] As this Court said in *Rice v. Santa Fe Elevator Corp.*, 331 U.S. 218, 236 (1947): "Congress can act so unequivocally as to make it clear it intends no regulation except its own."

[13] *Virginia State Corp. Comm'n v. FCC*, 737 F.2d 388, 392 (1984); P. App. 10.

[14] J. Sutherland, *Statutes and Statutory Construction*, § 46.05, § 46.06 (4th ed. 1975).

The court below, relying on its own decisions, and on *Fidelity Federal Savings and Loan Ass'n v. de la Cuesta*, 458 U.S. 141 (1982), concluded that "an appellate court is not to focus *narrowly* on Congress' own intent specifically to supersede state regulation" (emphasis added) but is to determine "whether the federal agency entrusted with administering the Act meant to preempt."[15] Such a standard of analysis is breathtaking; it leaves federal agencies free to encroach on state authority at will. It is consistent neither with principles of delegation of authority nor with this Court's expression of the preemption doctrine.[16] The intent of the agency can control only if the agency is acting within the scope of its authority.[17] The mere expression of agency intention is not sufficient to give an agency authority which it does not have.

The legislative history, which petitioners California and Public Utilities Commission of California review in detail in their brief on the merits, lends strong support to the view that Congress intended, quite unambiguously, to maintain the existing system of state regulation of *intrastate* communications.

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[15] *Virginia State Comm'n* at 393; P. App. 12.

[16] *Metropolitan Life Ins. Co. v. Massachusetts*, —— U.S. at ——, 105 S.Ct. at 2390; "The presumption is against preemption and we are not inclined to read limitations into federal statutes to enlarge their preemptive scope." *Chrysler Corp. v. Brown*, 441 U.S. 281, 302 (1979); the exercise of quasi-legislative authority by agencies must be rooted in a grant of such power by the Congress and subject to limitations which that body imposes.

[17] In *de la Cuesta*, the agency's authority stemmed from its control over federally created institutions, the federal savings and loan associations. Looking to the governing statute, this Court said that it would be difficult to give the federal bank board a broader mandate. 458 U.S. at 161.

II. STATE REGULATION OF *INTRASTATE* RATES DOES NOT ENCROACH ON FCC AUTHORITY TO SET INTERSTATE RATES, NOR IS THERE A CONFLICT WITH THE CONGRESSIONAL PURPOSE.

The opinion below reads into the statute and the legislative history of the Communications Act some intent by Congress to preempt by implication the existing state regulation of *intrastate* depreciation. Even if the express language of the Act is disregarded, this attempt to find a preemptive intent lurking in the interstices of the statute must fail.

It is undisputed that the Act contains no explicit preemptive language. Preemption of state law is not favored "in the absence of persuasive reasons—either that the nature of the regulated subject matter permits no other conclusion, or that the Congress has unmistakably so ordained." *Alessi v. Raybestos-Manhattan, Inc.*, 451 U.S. 504, 522 (1981). Congress' intent to supersede state law may be inferred only if the scheme of federal regulation is "so pervasive as to make reasonable the inference that Congress left no room for the States to supplement it" or because the act touches "a field in which the federal interest is so dominant that the federal system will be assumed to preclude enforcement of state laws on the same subject." *Rice v. Santa Fe Elevator Corp.*, 331 U.S. 218, 230 (1947). The Communications Act, which is premised on dual regulation by state and federal authorities, cannot easily be read as prohibiting state regulation of *intrastate* communications or as precluding enforcement of state laws. There is a presumption, moreover, that "Congress did not intend to pre-empt areas of traditional state regulation." *Metropolitan Life Insurance Co. v. Massachusetts*, —— U.S. at ——, 105 S.Ct. at 2389.[18]

[18] Regulation of public utilities and specifically their rates and services have "characteristically" been governed by the states. *Arkansas Elec. Coop. Corp. v. Arkansas Pub. Service Comm'n*, 461 U.S. 375, ——, 103 S.Ct. 1905, 1908 (1983). "The state concern that rates be fair and efficient represents a clear and substantial governmental interest." *PG&E v. State Energy Comm'n*, citing *Central Hudson Gas & Electric Corp. v. Public Service Comm'n*, 447 U.S. 557, 569 (1980), 461 U.S. 190, ——, 103 S.Ct. 1713, 1723 (1983).

Congress, when enacting legislation, frequently retains a significant role for state and local governments; for reasons rooted in the nature of American government, preemption of state law is not favored. The Federal Communications Act is not unique; many statutes contain an expression of a "national policy" to favor some goal such as the consumption of coal, the production of nuclear power, or an efficient national communications service. In such cases, "it is necessary to look beyond general expressions of 'national policy' to specific federal statutes with which the state law is claimed to conflict." *Commonwealth Edison Co. v. Montana*, 453 U.S. 609, 634 (1981).[19] The "national policy" alone is not sufficient to overcome the Congressional intention not to preempt state law. *See Commonwealth Edison v. Montana*, 453 U.S. at 634-35; *Pacific Gas & Electric Co. v. State Energy Resources Conservation & Development Commission*, 461 U.S. 190, 103 S.Ct. 1713 (1983); *Exxon Corp. v. Governor of Maryland*, 437 U.S. 117 (1978).

When Congress, as it did in the Federal Communications Act, deliberately chooses to retain state regulation, "state law is nullified to the extent that it actually conflicts with federal law," either because compliance with both laws is a physical impossibility or because the state law "stands as an obstacle to accomplishment and execution of the full purposes and objectives of Congress." *de la Cuesta*, 451 U.S. at 153; *Hillsborough County, Florida v. Automated Medical Laboratories*, —— U.S. at ——, 105 S.Ct. at 2375.

[19] Recently, this Court said: "[E]very subject that merits congressional legislation is, by definition, a subject of national concern. That cannot mean, however, that every federal statute ousts all related state law." *Hillsborough County, Florida v. Automated Medical Laboratories, Inc.*, —— U.S. ——, 105 S.Ct. 2371, 2378 (1985).

The court below did not find that compliance with both state and federal laws is impossible. Indeed, different federal and state depreciation schedules have coexisted since the Act's passage. However, the court concluded that retention of state authority to set *intrastate* depreciation schedules may have an "attenuated" effect on "the conduct and development of interstate communications." Such an "attenuated" effect cannot justify federal preemption of state authority under an Act that expressly provides for the exercise of such authority.

The FCC's explicit authority, under Section 220(b) of the Act, to prescribe depreciation practices, extends only to interstate services. The FCC, having deregulated the interstate telephone system, now finds it necessary to provide for "adequate capital recovery" and asserts that state depreciation prescriptions for *intrastate* rate setting would frustrate the Commission's self-declared national policy.[20] Accordingly, the agency asserts that it has primary authority to prescribe depreciation practices which preempt any state authority.

This assertion of preemptive authority reads out of the statute Congress' explicit decision to maintain state authority over *intrastate* services and rates. "Though offered wide latitude in this supervision over communication by wire, the Commission was not delegated unrestrained authority." *FCC v. Midwest Video Corp.*, 440 U.S. 689, 706 (1979) Congressional guidance is not lacking; not only are there "strong indications that agency flexibility was to be sharply delimited" (*id.* at 708), but Congress drew a line and forbade the agency to cross it.

The FCC finds encroachment on *its* national policy because state depreciation practices have a "substantial effect" on interstate rates which would frustrate vital national policies. If *intrastate* depreciation practices

[20] *In re Amendment of Part 31*, 92 F.C.C.2d 864 (1983); P. App. 74.

have a "substantial effect" on interstate rates, a change in those practices to meet the new federal mandate would even more clearly affect *intrastate* rates, an area reserved to state regulation.[21] The effect on *intrastate* rates will not be attenuated but direct and substantial.

Moreover, upholding the FCC's asserted authority to prescribe uniform depreciation rates would lead inevitably to uniform national rate setting. Appellees AT&T and the Bell Operating Companies contend that the FCC decision does not preempt the field of *intrastate* ratemaking because it "affects only a single element in the ratemaking equation." (Consol. Motion to Dismiss at 15) All else is to remain the province of the states. The FCC, like the camel, asks only to have its nose admitted into the tent.[22]

Ratemaking involves establishing a formula, determining the facts and setting the appropriate rates. The essential reason advanced by the FCC for preempting state depreciation practices is to generate a quicker capital return. But any factor in the state formula adopted by the states to compensate for the effects of the federally prescribed accelerated depreciation schedules would similarly interfere with the FCC's intent to increase capital recovery, and would be similarly preempted under the Commission's reasoning. The inevitable result will be continued encroachment by the FCC on the state ratemaking formulas, to ensure that the national communications industry thrives.

[21] Interstate telephone calls amount to only 3% of telephone calls made. Seventy-five percent of telephone facilities are *intrastate*. *Intrastate* service carries the load.

[22] "To evil habit's earliest wile
"Lend neither ear, nor glance, nor smile—
"Choke the dark fountain ere it flows,
"Nor e'en admit the camel's nose."
Lydia Huntley Sigourney, *The Camel's Nose, st. 4*

III. THE QUESTION OF EXPANDING FCC JURISDICTION TO SET *INTRASTATE* RATES IS PROPERLY RESERVED TO THE CONGRESS.

The FCC action reverses a decision long ago made by Congress. The Act left control of *intrastate* ratemaking in the hands of the state commissions when it consolidated federal control of interstate communications in the FCC. The decision below, however, choosing not to "focus narrowly" on Congress' expressed intent, accepted the FCC's broad interpretation of its own authority. Such deference to an agency's interpretation of its own powers is unwarranted.

That interpretation files in the face of the language of the authorizing statute, and contradicts well-established principles of the preemption doctrine. Moreover, it disregards this Court's instruction in *Garcia v. San Antonio Metropolitan Transit Authority*, —— U.S. ——, 105 S.Ct. 1005 (1985): "The political process insures that laws that unduly burden the states will not be promulgated." *Id.* at 1020. In promulgating the Communications Act, Congress was clearly responding to the political realities of the dual regulatory system which was already in place. It chose to maintain that system, in preference to granting the FCC jurisdiction to preempt existing state authority.

Section 220(j) of the Act instructed the Commission to "investigate and report to Congress as to the need for legislation to define further or harmonize the powers of the Commission and of State commissions" with respect to accounting and depreciation matters.[23] If the FCC or the interstate communication industry wished to expand the Commission's authority, the remedy was to report the problem to Congress, not to take unilateral agency action in an area deliberately reserved to the states.

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[23] 47 U.S.C. § 220(j).

Given the statutory scheme, it is for Congress to rethink the division of regulatory authority in light of the contentions of the FCC and the telecommunications industry that the states' exercise of their reserved regulatory authority undercuts the federal objectives. *Pacific Gas & Electric Co. v. State Energy Resources Conservation & Development Comm'n*, 461 U.S. 190, 103 S.Ct. 1713 (1983).

CONCLUSION

For the foregoing reasons, the judgment of the court below should be reversed.

Respectfully submitted,

BENNA RUTH SOLOMON
Chief Counsel
JOYCE HOLMES BENJAMIN *
THE STATE AND LOCAL LEGAL CENTER
444 North Capitol Street, N.W.
Suite 349
Washington, D.C. 20001
(202) 638-1445
* *Counsel of Record for the Amici Curiae*

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Nos. 84-871, 84-889, 84-1054, and 84-1069

In the Supreme Court of the United States
October Term, 1984

Louisiana Public Service Commission, Appellant
v.
Federal Communications Commission and
United States of America, Appellees

California and Public Utilities Commission
of California, et al., Petitioners
v.
Federal Communications Commission and
United States of America, Respondents

Public Utilities Commission of Ohio,
et al., Petitioners
v.
Federal Communications Commission and
United States of America, Respondents

Florida Public Service Commission, Petitioner
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Federal Communications Commission and
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AMICI CURIAE BRIEF
IN SUPPORT OF APPELLANT AND
PETITIONERS

WILLIAM J. GUSTE, JR.
Attorney General
State of Louisiana
RICHARD M. TROY
Assistant Attorney General
7th Floor, 234 Loyola Avenue
New Orleans, Louisiana 70112
J. DAVID MCNEILL III
COUNSEL OF RECORD
Assistant Attorney General
7434 Perkins Road
Baton Rouge, Louisiana 70808
Telephone: (504) 922-0187

JOHN L. GUBBINS
JEFFREY C. PAULSON
John Gubbins, Ltd.
20 North Clark Street, Suite 2600
Chicago, Illinois 60602
Illinois Citizens Utility Board
108 North State Street
Chicago, Illinois 60602

JOEL BLAU
PHILIP S. SHAPIRO
New York State Consumer Protection
Board, Utility Intervention Unit
99 Washington Avenue, Suite 1020
Albany, New York 12210

BARRY ZITSER
Consumer Counsel of the
Connecticut Division of
Consumer Counsel
One Central Park Plaza, Room 105
New Britian, Connecticut 06051

CORRINE K. A. WATANABE
Attorney General
State of Hawaii
RONALD SHIGEKANE
Deputy Attorney General
Consumer Advocate, Director of Department
of Commerce and Consumer Affairs
State Capitol
Honolulu, Hawaii 96813

BRIAN BURNETT
Assistant Attorney General
Utah Attorney General's Office
130 State Capitol Building
Salt Lake City, Utah 84114
Utah Committee of Consumer Services
408 Heber M. Wells Building
160 East 300 South
Salt Lake City, Utah 84145

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STATEMENT OF INTEREST

The Illinois Citizens Utility Board (CUB) is a non-profit public membership organization created to "represent and protect the interests of the residential utility consumers of the State" before the Illinois Commerce Commission, Federal Communications Commission, and other appropriate judicial and administrative bodies. Ill. Rev. Stat. ch. 111-2/3, § 905(a) (1983). CUB's activities are intended to promote the health, welfare, and prosperity of all the citizens of Illinois, and this purpose is considered to be a statewide public interest, not a private or special concern. CUB has over 120,000 contributing members and has participated in regulatory and legislative proceedings on behalf of

Illinois customers of telephone and telecommunications companies.

The Attorney General of Louisiana is the Chief Legal Officer of the State of Louisiana and is empowered to represent the interests of consumers in the State of Louisiana. La. Const. art. 4 § 8. Such authority includes the power to represent citizens of the State of Louisiana with respect to the rates and services of telephone companies and other public utilities.

The New York State Consumer Protection Board is a New York State Executive Department Agency authorized and empowered to represent the interests of the consumers of the State of New York. N.Y. Exec. Law §§ 552, 553. Such authority includes the power to represent consumers with respect to the

rates and services of telephone companies and other public utilities.

The Connecticut Consumer Counsel is the statutory advocate for the interests of Connecticut utility consumers.

The Consumer Advocate, Director of Department of Commerce and Consumer Affairs, of the State of Hawaii is designated by statute to represent the interests of all consumers in the state of Hawaii.

Under Utah state law, the Utah Committee of Consumer Services is to assist and represent residential, small business, and agricultural consumers of natural gas, electric, and telephone utilities before the Utah Public Service Commission and on appeals.

As detailed with respect to Illinois in Section B of the Argument, CUB and the other amici are interested in this proceeding for two significant reasons. First, affirmance of the Fourth Circuit decision is likely to have a dramatic and adverse impact on consumers' intrastate telephone rates. Second, the legitimacy of State regulatory objectives and mechanisms for telephone rates and services will be substantially jeopardized by an affirmance.

SUMMARY OF ARGUMENT

The purpose of this amicus brief is to address points not covered, or not covered in great detail, by Petitioners and to bring to the Court's attention the consequences of its decision in this case for continued State regulation of intrastate telephone companies and their customers. Amici discuss whether the plain language and intent of the Federal Communications Act 47 U.S.C. §§ 151 et seq., (Act) deprive the FCC of the authority to preempt State ratemaking jurisdiction over intrastate telephone companies and services. Amici emphasize, in particular, the lengthy history and pervasive scope of state telephone regulation, and the continuation of such regulation in the future in pursuit of

important State public policy objectives and indicate further that this traditional exercise of State regulatory powers creates a strong presumption against preemption. Further, amici discuss the provisions and historical context of Section 2(b) of the Act and argue that the clear Congressional intent embodied therein is to protect state regulatory authority over intrastate telephone service against federal encroachment.

ARGUMENT

SECTION 2(b) OF THE ACT PRECLUDES THE FCC FROM PREEMPTING STATE AUTHORITY TO SET RATES FOR INTRASTATE TELEPHONE SERVICE

A. Preemption Of Powers Historically Exercised By States May Not Be Sustained In The Absence Of Manifest Evidence Of Congressional Intent To Authorize Preemption.

Express federal preemption of state law or power has only been upheld in instances where Congress has explicitly indicated such an intent. Sufficiently strong indications may arise from the plain terms of the federal law or because the federal regulatory scheme is so pervasive as to leave no doubt, in the absence of statutory exemptions to the contrary, that Congress intended to preclude State action in the field. Pacific Gas and Electric Co. v. State Energy Resources Conservation and Development Comm'n, 461 U.S. 190, 203-4 (1983); Fidelity Federal Savings and Loan Assn. v. De la Cuesta, 458 U.S. 141, 153 (1982).

In either instance, however, if the area to be preempted is one in which states have traditionally

exercised their police powers, preemption will not be presumed lightly; it will be sustained only where the Congressional intent to preclude state action is "unambiguous" and "unmistakably ordained." *Florida Lime and Avocado Growers, Inc. v. Paul*, 373 U.S. 132, 142, 146-7 (1963). In such a case, analysis must begin with the assumption that federal law was not intended to supersede the historic police powers of the State unless that was the "clear and manifest purpose of Congress." *Rice v. Santa Fe Elevator Corp.*, 331 U.S. 218, 230 (1947). This assumption serves to assure that the balance between federal and state powers will not be disturbed unintentionally by Congress or unnecessarily by the courts. *Jones v. Rath Packing Co.*, 430 U.S. 519,

525 (1977). Unless Congress has openly forsaken the critical balance of federal and state authority in favor of exclusive federal power, attempts to preempt the legitimate operation of state law must therefore be proscribed.

The Fourth Circuit's opinion ignores this test for measuring the propriety of preemptive action by the federal government. In fact, the Court does not discuss in any significant fashion the intent of Congress with respect to the preemptive limitations of the Act. The Court, instead, skips immediately to determine whether state law or policy "might" frustrate federal objectives. By so doing, the Court eliminates any burden on the federal agency to justify its infringement upon State authority, and thereby makes it

easy to find any speculative impediment attributable to state law sufficient to warrant preemption, irrespective of Congressional intent. Such an analysis effectively circumvents any restrictions on the federal power to preempt; any preemptive action could be justified by "possible" frustration despite Congressional intent to the contrary, or in the face of serious doubt as to whether Congress authorized such action. This approach exalts deference to federal agencies and courts at the expense of Congress and the States, upsetting the balance of state and federal powers. Such federal overreaching is neither compelled nor justified by the Supremacy Clause or this Court's decisions. See U.S. Const. art. 6, cl. 2. The starting point for

analysis must instead be, as this Court has consistently held, whether Congress has evidenced an intent to explicitly authorize or proscribe the particular preemptive action at issue, for in the absence of such authority, preemption cannot be sustained regardless of potential "frustration."

B. States Have Traditionally Exercised Their Police Powers To Regulate The Intrastate Rates, Charges, Services and Operations Of Telephone Companies.

Modern regulation of electric, gas and telephone utilities began at the state level in Wisconsin in 1907. By 1930, all but three states had initiated fairly extensive regulation of intrastate telephone rates and services, Wheat, The Regulation of Interstate Telephone Rates, 51 Harv. L. Rev. 846, 847 (1938), and all states currently

have such regulation. Most states did not distinguish between types of public utilities in establishing the scope and nature of their regulatory objectives and legislation and, as a result, intrastate state telephone service has been accorded state regulation to the same extent as electricity and natural gas. This Court has recently recognized the critical importance of state public utility regulation in the context of electricity, recognition which should similarly be extended to state telephone regulation. *Pacific Gas and Electric Co. v. State Energy Resources Conservation and Development Comm'n*, 461 U.S. 190, 205-6 (1983) and cases cited therein.

The experience of Illinois is typical of most states, and may be used

as an example of the nature and importance of state telephone regulation. The Illinois Public Utilities Act (PUA) was first enacted in 1913 and reenacted without significant change in 1921. Ill. Rev. Stat. ch. 111-2/3, §§ 1 et seq. In short, the purpose of the PUA is to assure the availability of efficient utility service at reasonable and equitable rates to as many citizens as possible. Report of the Special Joint Committee to Investigate Public Utilities, 48th Gen. Ass., 1913 Sen. Jl. 830, 862. At the same time, utilities are to receive a fair return on their property, including sufficient income to ensure ongoing reinvestment in the business. Id. at 955. The means of balancing these objectives is codified in the PUA and

the authority to do so is vested in the Illinois Commerce Commission (ILCC).

The provisions of the PUA provide plenary power to the ILCC to regulate Illinois public utilities and their intrastate activities. People v. City of Chicago, 349 Ill. 304, 182 N.E. 419 (1932). "Public utilities" subject to the PUA has always included companies involved in the transmission of telephone messages between points within the State. 1921 Ill. Laws 702, § 10.3(a); PUA, § 10.3(b), Ill. Rev. Stat. ch. 111-2/3, § 10.3(b) (1983). The ILCC has comprehensive powers over such companies, including the power to generally supervise management, PUA, § 8, Ill. Rev. Stat. ch. 111-2/3, § 8; to order construction or alteration of any utility facilities, Id., §§ 48, 49,

50, Ill. Rev. Stat. ch. 111-2/3, §§ 48, 49, 50; to require accounting and reporting, Id. §§ 9, 11-19, Ill. Rev. Stat. ch. 111-2/3, §§ 9, 11-19; to control financing and intercorporate relations, Id. §§ 8a, 20-29, 31, Ill. Rev. Stat. ch. 111-2/3, §§ 8a, 20-29, 31; and to examine and determine utility rates and services, Id., §§ 32-40, 41-43, Ill. Rev. Stat. ch. 111-2/3, §§ 32-40, 41-43. The ILCC's determinations are generally subject to notice and hearing, PUC, §§ 3, 60-67, Ill. Rev. Stat. ch. 111-2/3, §§ 3, 64-71, and to full judicial review, Id., §§ 68-71, Ill. Rev. Stat. ch. 111-2/3, §§ 72-75.

Of these various powers, the most important is the ability to evaluate and establish utility rates.

Report of the Special Joint Committee, supra, at 955. Rates must be just and reasonable to both the public and the utility, Id.; State Public Utilities Comm'n v. Springfield Gas and Electric Co., 191 Ill. 209, 125 N.E. 891 (1920). In this respect they must not be excessive, so that citizens are able to obtain and afford utility service, Report of the Special Joint Committee, supra, at 934, and at the same time must be sufficient to ensure reinvestment through depreciation and other means in order to provide high-quality and efficient service. Id. at 862, 933-36, 955; PUA §§ 32, 36, Ill. Rev. Stat. ch. 111-2/3, §§ 32, 36. In setting rates for utility services, including intrastate telephone services, the ILCC must constantly wrestle with the

inherent tension between the objectives of affordable and reasonable prices, so as to promote wide availability of service to the public, and efficient utility service which can only be obtained through a sufficient level of reinvestment.

The intersection of these ratemaking objectives is the determination of an appropriate level of depreciation. The ILCC is specifically empowered to "require any or all public utilities to keep such accounts as will adequately reflect depreciation, obsolescence and the progress of the arts" and to fix the proper and adequate rate of depreciation for utility property. PUA, § 14, Ill. Rev. Stat. ch. 111-2/3, § 14. Every public utility must conform its accounts to the

depreciation rates determined by the ILCC. *Id*. Illinois courts have sustained the ILCC's authority to consider evidence of depreciation and obsolescence, *Peoples Gas Light and Coke Co. v. Slattery*, 373 Ill. 31, 25 N.E.2d 482, *appeal dismissed* 309 U.S. 634 (1940), and this Court has upheld the ILCC's authority to establish an appropriate amount of depreciation expense for intrastate telephone ratemaking and the propriety of including depreciation as an expense underlying the determination of reasonable rates. *Lindheimer v. Illinois Bell Telephone Co.*, 292 U.S. 151 (1934); *Smith v. Illinois Bell Telephone Co.*, 282 U.S. 133 (1930). Moreover, courts have interpreted Illinois law to require the inclusion of

depreciation expense in setting rates which are as low as possible for the public. Illinois Bell Telephone Co. v. Commerce Commission, 414 Ill. 275, 286, 111 N.E.2d 329, 335 (1953).

Consistent with this authority, for seventy years the ILCC has required Illinois telephone utilities to account for depreciation and has included an appropriate amount for annual depreciation expense in the expenses of such companies for intrastate ratemaking purposes.[1] See,

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1/ Aside from the plain language of Section 14 of the PUA, there are other indications that the concept of depreciation in Illinois utility law includes the phenomenon of obsolescence; the retirement, earlier than originally anticipated, of property or equipment replaced by technologically superior or more economical machinery. As emphasized by the General Assembly, one key goal of the PUA is to

(Footnote Continued On Next Page)

e.g., *Re Ross*, 1915D P.U.R. 646 (Il.C.C.): *Re Colchester Farmer's Telephone Co.*, 1915E P.U.R. 23 (Il.C.C.). Depreciation expense has always constituted a substantial percentage of the expenses of Illinois telephone utilities. For example, even in the earlier days of regulation,

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ensure that the standard of service keeps pace with the needs of the public and with the rapid improvement in methods and applications and to make certain that efficiency of service is a factor in utility capitalization. *Report of the Special Joint Committee*, *supra*, at 933, 935. The ILCC is supposed to adjust occasionally as it is forced to confront recurring, unsettled questions arising as new methods of operation and improvements in machinery are devised. *Id.*; *See*, *Lindheimer v. Illinois Bell Telephone Co.*, *supra*, at 167 (depreciation embraces wear and tear, decay, inadequacy, and obsolescence).

annual depreciation expense comprised roughly 13 to 17 percent of Illinois Bell Telephone's operating expenses. Lindheimer v. Illinois Bell Telephone Co., 292 U.S. 151, 174 (1934), (comparison of note 25 with text). More recently, annual depreciation expense for ratemaking purposes exceeded $350 million, approximately 27.6 percent of Illinois Bell's total expenses, exclusive of taxes, and is the largest single expense item. Re Illinois Bell Telephone Co., 57 P.U.R. 4th 225, 261 (1983). Significant increases in annual depreciation expense also necessarily result in significant increases in a telephone utility's revenue requirement and ultimately its rates for customers.2/ Consequently, substantial

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2/ Rates are established to recover a "revenue requirement" which, in

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increases in depreciation expense can have dramatic impacts upon the affordability of telephone service and threaten the achievement of the State objective to make telephone service as widely available as possible.

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turn, equals the sum of all allowable expenses (including annual depreciation expense) and the product of the allowed rate of return and rate base. Rate base, in its simplest form, is the value of the company's property minus accrued depreciation for such property. An increase in annual depreciation expense increases total expenses dollar-for-dollar. However, the resulting increase in revenue requirement is partially offset by the increased addition to accrued depreciation which diminishes rate base. Thus, depending on the precise rate of return, among other things, a $100 increase in annual depreciation expense may result in only an $80 to $90 increase in rates, still a significant correlation.

Recent changes in depreciation policy in Illinois, caused in large part by FCC decisions, have led to increases in depreciation expense and telephone rates for intrastate service, accompanied by growing pressure on affordability. For example, Illinois Bell recently received approval to shorten the amortization period for the recovery of embedded station connections and inside wire costs from ten years to six years. The effect of Bell's proposal was to increase annual depreciation expense by approximately $65 million and the revenue requirement by about $50 million. Id., 57 PUR 4th at 237. Illinois Bell's additional proposed 1984 changes in depreciation policy were forecasted to increase depreciation expense by another $83

million and revenue requirements by roughly $63 million. Id., Second Interim Order at 4, (slip op. October 30, 1984). The effect of such rate increases is heightened by the additional proposal to recover such costs through increased customer service charges, thereby imposing additional inflexible barriers to affordable service. See Re Illinois Bell Telephone Co., Proposed Increase In Service Charges, Il.C.C. Dkt. 81-0115, (slip op., January 24, 1982). Thus, recent changes in depreciation policy have already placed a great deal of strain upon Illinois regulators as they continue to try to balance the conflicting state goals of affordability and efficiency in the provision of intrastate telephone service.

The dramatic transformation of the telecommunications industry, therefore, has enhanced, not diminished, the importance of intrastate telephone regulation to the States and their citizens. Certainly, this transformation was largely occasioned by factors outside of State control: improvements in technology opening certain markets to competition, changes in FCC policy in pursuit of deregulation, and the restructuring of American Telephone and Telegraph Co. (AT&T). State legislators and regulators, in acknowledging these changes and their effects, have chosen to revamp but not eliminate their regulation of intrastate telephone service, in order to ensure the continued attainment of important state

policy objectives. Far from being irrelevant, State telephone regulation is more critical than ever to the achievement of efficient and universally available service, since the balance between such conflicting goals has been made more precarious by the introduction of competition.

Again, the Illinois response serves as an instructive example of State reaffirmation of traditional regulatory objectives in the context of adapting to a transformed environment. Pursuant to provisions in Illinois's "Sunset" laws[3] a special bipartisan

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3/ Regulatory Agency Sunset Act, §§ 1, et seq., Ill. Rev. Stat. ch. 127, §§ 1901 et seq; Regulatory Reform Act of 1979, §§ 1 et seq., Ill. Rev. Stat. ch. 127, §§ 1951 et seq. The first of these Acts provided for automatic repeal of the Illinois PUA on December 31, 1985, unless the General Assembly

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committee of legislators and public members conducted a comprehensive two year evaluation of public utility regulation in Illinois, with a special emphasis on the nature of future state telecommunications regulation. The culmination of the effort, involving input from companies, government, large consumers, regulators and the public, was House Bill 1814 which was passed by the General Assembly in June, 1985. A-1. Many other states have undertaken, or will be undertaking, similar efforts and a large number have enacted legislation with roughly the same purposes as HB 1814. See e.g., Moore

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reenacted it or adopted a new regulatory scheme. Sunset Act, § 4.3, Ill. Rev. Stat. ch. 127, § 1904.3 (1983).

Universal Telephone Service Act, Cal. Rev. & Tax Code § 44000 et seq. (West Supp. 1985); N.C. Gen. Stat. §§ 62-3, 62-110 (1984 Int. Supp.); Va. Code §§ 56-481.1, 56-482.1, 56-484.2 (1985 Supp.).

HB 1814, The Universal Telephone Service Protection Law of 1985 (Universal Service Law), has several major objectives. The bill recognizes the importance of universal telephone service, the need to revise regulatory practice to respond to changes in the industry, the potential for competition as a means of providing service and the need to continue regulation of intrastate telephone service to protect and promote the well-being of all Illinois citizens. Universal Service Law, § 1 para. 13-101, A-1. HB 1814

establishes as state policy that telecommunications services should be "available to all Illinois citizens at just, reasonable and affordable rates" and that any modifications to State regulation should be implemented in a way which minimizes the possible disruptions to the system or customers. Id. § 1, paras. 13-103(a),(c); A-1, 2-3. To the extent consistent with other public policy objectives, such as universal service, competition is to be utilized as a means of providing telephone service, where it is also a more viable and economic mechanism than regulated monopoly. Id., § 1, para. 13-103(b), A-2. Finally, HB 1814 mandates that rates and charges for noncompetitive telecommunications services shall not in any way subsidize

the provision of competitive services. Id., § 1, paras, 13-103(d), 13-507, A-3, 21-23.

To achieve these objectives, the new Act creates a regulatory mechanism with sufficient flexibility to accomodate both regulated and competitive markets for the provision of services, and is designed to provide time for an orderly transition between regulated and competitive services in those intrastate markets where a switch from regulated monopoly to competition is viable and consistent with the public interest. Those services for which competition is not viable will continue to be subject to traditional regulatory principles. Id., § 1, paras. 13-101, 13-504, A-1, 18-19. Competitive services and rates therefore will be

subject to relatively little regulatory oversight. In general, local exchange service, because of its fundamental importance to universal service and because it is least susceptible at this time to widescale competition is more stringently protected and regulated.

Conversely, the competitive provision of inter-MSA service is anticipated much sooner and, if viable, will be subject to the marketplace rather than regulatory pressures. (Compare Id. § 1, para. 13-405 with para. 13-403; and § 1, para. 13-504 with para. 13-505. A-11-14, 18-20.) In short, the Universal Service Law recognizes the feasibility of competition without promoting it and accomodates such competition where it is demonstrably feasible and not

inconsistent with the protection and pursuit of other legitimate state policy objectives.

HB 1814 recreates an old balancing act for the ILCC by forcing it to address, in the context of a changing industry, the conflicts between preserving universal service and reasonable rates and the recovery of costs incurred in a transition to competitive service. This task is inherently complex and controversial, with serious consequences for all parties. It cannot be cavalierly dismissed as irrelevant or adequately resolved by a presumptous blindness which typically accompanies rigid adherence to ideological purity or textbook economic theory. Instead, the State of Illinois, as most states, has

chosen to responsibly reaffirm its commitment to fundamental public policy goals and has dedicated its powers to the accomplishment of those goals to the fullest extent possible. State authority to regulate intrastate rates is essential to the State's ability to establish and implement its goals in this area of critical importance to citizens. It is vital that this Court recognize the significance and legitimacy of State power and activities in this regard and consequently place a heavy burden on Respondents to justify their attempt to displace the States from their traditional role as protectors of the public interest in reasonable and affordable intrastate telephone rates and services.

C. The Terms And History Of The Communications Act Conclusively Demonstrate A Congressional Purpose To Prevent The FCC From Displacing Traditional State Ratemaking Authority For Intrastate Telephone Service.

When enacted, the Federal Communications Act of 1934, 47 U.S.C. §§ 151 et seq. (Act) was clearly designed to strengthen and consolidate federal jurisdiction over the provision of interstate communications services, including telephone service. The Act establishes broad authority on the part of the FCC to regulate interstate communications services in pursuit of statutory objectives. See Act, § 1, 47 U.S.C. § 151. This Court has also held, with respect to the broadcasting area, that the Act confers sufficient authority and flexibility upon the FCC to permit adjustment to new and dynamic

changes in the interstate communications industry. United States v. Southwestern Cable Co., 392 U.S. 157 (1958).

Perhaps in recognition of the expansive powers which it was creating in the FCC and the dangers inherent therein, Congress expressly and emphatically enacted limitations upon such powers beyond which it did not wish the agency to act. As a general matter, the Act throughout its entirety operates only to create jurisdiction over interstate communications. "Interstate communications," in turn, is defined to mean only transmissions or communications between states or, to some extent outside the United States, but does not, with respect to telephone messages, include communications "between points in the same State... or

the District of Columbia, through any place outside thereof, if such communication is regulated by a State commission." Act, § 3(e), 47 U.S.C. 153(e). "State Commission" means any commission or organization which has regulatory jurisdiction with respect to the intrastate operations of carriers. Id., § 3(t), 47 U.S.C. § 153(t). These provisions, taken together, manifest the intention of Congress to restrict the scope of the FCC's expansive powers to interstate communications and to proscribe the exercise of such powers over intrastate telephone service regulated by States.

As if its intent were not sufficiently apparent Congress also included Section 2(b) which more explicitly reserves to the States their

ability to regulate intrastate telephone services. Act, § 2(b), 47 U.S.C. § 152(b). Section 2(b) provides, in pertinent part, that:

> [N]othing in this chapter shall be construed to apply or to give the Commission jurisdiction with respect to (1) charges, classifications, practices, services, facilities, or regulations for or in connection with intrastate communications service by wire or radio of any carrier . . .

47 U.S.C. § 152(b). On its face, then, the Act is unambiguous as to the intent of Congress to deprive the FCC of jurisdiction over intrastate matters traditionally regulated by the States, including the determination of "charges" for intrastate services, of which depreciation expense is a part.

This Court has repeatedly held that where, as here, the language of a statute is clear and the construction

thereof does not lead to absurd consequences, the statutory terms are to be considered to mean what they say. *United States v. Missouri Pacific R.R. Co.*, 278 U.S. 269, 278 (1929). Although the Court has recently taken exception to this rule even where statutory language has appeared plain, the circumstances justifying such exceptional investigations are not present in this case. *See Philbrook v. Glodgett*, 421 U.S. 707, 714 (1975). And the Court has indicated that it will not cast aside common sense in statutory interpretation to reach a convoluted result at cross-purposes with Congressional intent. *See Philko Aviation, Inc. v. Shacket*, 462 U.S. 406 (1983). In this case, the FCC's interpretation of the Act defies common

sense and is openly inconsistent with Congress's evident intent to preserve State ratemaking authority. The application of the "plain meaning" of Section 2(b) is unambiguous and the consequences are sensible and consistent with the entirety of the Act.

Section 20(b) of the Act, 47 U.S.C. § 220(b), relied upon by Respondents, does not detract from amici's interpretation. That section grants the FCC the power to prescribe the accounts and records which must be maintained "by carriers subject to this chapter" and requires, in particular, that the FCC prescribe for "such carriers" appropriate depreciation expenses. In addition, such carriers are prohibited from including in any form a depreciation schedule or expense

which might be included elsewhere as a depreciation charge or expense. Id. Respondents argue that this language not just permits, but requires preemption of State depreciation policies.

The meaning of these provisions of Section 20(b) is easily ascertained and fully consistent with amici's reading of Section 2(b) when read in the context of the entire Act. Since the carriers "subject to this Act" are only those which provide interstate communication services, and only to the extent they provide such services, the FCC's authority to prescribe depreciation charges applies only to such interstate services for the purpose of interstate ratemaking. When submitting data or forms to the FCC in connection with interstate regulation or

ratemaking, carriers are not to submit information relating to depreciation charges used for any purpose other than FCC regulation, thereby simplifying FCC reporting and eliminating the possibility of confusion or deception at the FCC. Far from preventing the use of other depreciation schedules or charges, such as for tax or state regulatory purposes, the Section recognizes the likelihood that differing schedules will exist and accomodates that prospect in a manner which ensures accuracy in carrier compliance with FCC requirements for interstate regulatory purposes. This straightforward reading of the Act is most palatable with its context and purposes; such a simple "accuracy-in-reporting" provision cannot justify the FCC's far reaching attempt

at preemption in this case. Southwestern Bell Telephone Co. v. Arkansas Public Service Commission, 584 F. Supp. 1087, 1089 (E.D. Ark.), rev'd on other grounds, 738 F.2d 901 (8th Cir. 1984); Cincinnati Bell Telephone Co. v. Public Utilities Commission of Ohio, 12 Ohio St. 3d 280, 283-4 (1984).4/

While the statute on its face, therefore, provides sufficient evidence to conclude that Congress never intended to preempt state regulatory authority

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4/ As noted above, the Illinois PUA includes similar language with respect to the ILCC's authority to establish accounts for depreciation and prohibits inconsistent reporting by Illinois public utilities. The provisions have never been interpreted as precluding different accounting or reporting treatment for tax or regulatory purposes outside the scope of the PUA. PUA, § 14, Ill. Rev. Stat. ch. 111-2/3, § 14.

over intrastate telephone companies, the legislative history corroborates the fact that Congress intended, in fact, to clarify, preserve and expand then existing state jurisdiction. As outlined in detail, supra, states had been very active in regulating intrastate telephone companies from the inception of modern public utility regulation. The federal government first initiated its regulatory efforts over interstate telephone service with the passage of the Mann-Elkins Act, amending the Interstate Commerce Act. Mann-Elkins Act, ch. 309, § 7, 36 Stat. 544 (1910). There is little legislative history behind the amendment, but the effect was to subject telephone companies to the jurisdiction of the Interstate Commerce Commission (ICC) and

terms of the Interstate Commerce Act with respect to their interstate operations. Gabel, The Early Competitive Era in Telephone Communication, 1893-1920, 34 Law & Contemp. Prob. 340, 357 (1969).

Between 1910 and 1934 the ICC made little or no effort to regulate even interstate telephone services, let alone intrastate activities. The ICC only handled four rate cases, each of little significance, each initiated by complaint. Id. Further, the ICC felt initially that it lacked jurisdiction over the filing of interstate telephone rates. Unrepeated Message Case, 44 I.C.C. 670, 673-4 (1917), modified 61 I.C.C. 541 (1921). See Preliminary Report on Communication Companies, H.R. Rep. No. 1272, 73d Cong. 2d Sess. (1934)

at xvi. Necessarily, the ICC initially felt incapable of establishing depreciation expenses even for interstate ratemaking purposes as well, and the responsibility for intrastate ratemaking, including the establishment of appropriate depreciation expenses, remained with the States.

The ICC did, however, consider its jurisdiction sufficient to establish accounting and reporting requirements. See Wheat, The Regulation of Interstate Telephone Rates, 51 Harv. L. Rev. 846, 847 n.5 (1938). In particular, the Transportation Act of 1920 amended the Interstate Commerce Act and provided the ICC with the authority and duty to prescribe appropriate depreciation charges "for carriers subject to this Act."[5] 41 Stat. 456, 493 (1920).

5/ Section 20(5) of the Interstate Commerce Act was the immediate

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Relying on this provision the ICC initiated proceedings to ascertain appropriate depreciation policies for telephone companies. Over the objections of State commissions, the ICC concluded that Section 20(5) empowered it to prescribe depreciation policy and expenses for property used "almost exclusively" in intrastate service. Depreciation Charges Of Telephone Companies, 118 I.C.C. 295, 332 (1926). The ICC, however, did not seek to act upon such asserted jurisdiction and emphasized that it intended to continue to rely upon state commissions for intrastate depreciation determinations. Id. at 374.6/ The ICC continued to

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predecessor of Section 20(b) of the Communications Act, 47 U.S.C. § 220(b).

6/ The rationale for permitting continued State jurisdiction

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assert, while never exercising, jurisdiction over intrastate depreciation practices and related matters until the creation of the FCC. See Depreciation Charges of Telephone Companies, 177 I.C.C. 351 (1931); Accounting Rules For Telephone Companies, 203 I.C.C. 13 (1934).7/

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included a recognition that States were better informed and equipped than the ICC to determine appropriate depreciation policies for intrastate service. This reasoning reflects both an awareness of extensive State experience and expertise and a lack of resources on the part of the ICC to adequately perform such activities. Id. at 374-5. See, Preliminary Report on Communications Companies, supra, at xvi.

7/ Issued July 9, 1934, after the effective date of the Communications Act, Id., 203 I.C.C. at 14.

Contemporaneous United States Supreme Court decisions also implied strongly that State jurisdiction over intrastate telephone service might be in jeopardy. In Houston, East and West Texas Ry. Co. v. U.S., 234 U.S. 342 (1914) ("Shreveport Cases"), the ICC determined that carrier rates between points within Texas were discriminatorily low relative to rates for interstate service between Shreveport and Texas. The ICC ordered that rates for the interstate service should be set no higher than rates for comparable intrastate service. The Court, in upholding the ICC order, strongly held that Congress could authorize such action in order to protect interstate commerce despite any incidental encroachment upon State

authority which might necessarily result. Id. at 353-5. The Court further held that the relevant provisions of the Interstate Commerce Act manifested Congressional intent to endow the ICC with such authority, notwithstanding a general proviso in the federal law purporting to preserve State jurisdiction over intrastate traffic. Id. at 355-7. While the proviso was not thereby rendered meaningless,8/ the Court's opinion substantially restricted its applicability.

8/ The Court found that the proviso, Interstate Commerce Act, § 3, 36 Stat. 539, 545 (1910), although not referring specifically to State power to determine intrastate rates, did at a minimum reserve such authority exclusively to the States. Congress "did not undertake to authorize the [ICC] to prescribe intrastate rates" but left such rates subject to the authority of the States. Id. at 357.

In addition, in Smith v. Illinois Bell Telephone Co., 282 U.S. 133 (1930) the Court reviewed an order of the Illinois Commerce Commission (ILCC) with respect to intrastate telephone rates for Illinois Bell. In challenging the order, Bell asserted that Section 20(5) of the Interstate Commerce Act, supra, deprived the ILCC of the authority to establish depreciation expense for intrastate ratemaking by vesting exclusive power over depreciation in the ICC. The Court refused to so hold, at least until the ICC had taken some action indicating that it would attempt to exercise such exclusive jurisdiction. Id. at 159-60. In another portion of the opinion, however, the Court stressed the importance of properly maintaining the

boundaries between state and federal jurisdiction, and found that the ILCC had no authority to rule on the propriety of interstate telephone rates, since such power had been placed in the ICC. Id. at 148-9. The Court, therefore, recognized the ICC's exclusive authority over interstate telephone services and implied that, if the ICC took the requisite steps, its jurisdiction over intrastate depreciation policies and rates might also be upheld.

The point of this historical discussion is to place in context the subsequent actions and statements of Congress in its deliberations on, and drafting of, the Communications Act. By 1934, the ICC had emphatically stated that it already had jurisdiction over

intrastate depreciation policies and practices and implied with equal strength that given sufficient resources it might seek to assert such authority. The Supreme Court had demonstrated that the existing law might sustain such action, despite prior Congressional attempts to protect State jurisdiction over intrastate matters. Moreover, depreciation policy was a controversial regulatory issue of major importance at the time with respect to all utilities, awaiting and inviting definitive resolution.9/ Thus, the creation of a

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9/ For example, a large number of law review articles were written in the late 1920's and early 1930's analyzing the confusion surrounding depreciation law and policy. See, e.g., Wheat, The Regulation of Interstate Telephone Rates, 51 Harv. L. Rev. 846, 859 (1938); Roberts, Depreciation As An Element In Public Utility Valuation, 1 Mo. L. Rev. 145 (1936); Goddard, The

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federal regulatory commission with statutory powers equal to those of the ICC, and substantial resources as well, would pose a direct threat to States' ability to continue regulating intrastate telephone services, and related depreciation policy in particular.10/

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Interest Of Public Utility Ratepayers In Depreciation, 48 Harv. L. Rev. 721 (1935).

10/ It is significant to note that the problems of rapid technological change and the need to determine how to account for the undepreciated portion of obsolete plants are not recent or unprecedented issues in telephone regulation. From the first days of state regulation, commissions were cognizant of technological change and defined depreciation to include the effects of such obsolescence. See, for example, Re Webster Telephone Company, 1915E PUR 526 (S.Dak.) (depreciation defined to include obsolescence due to a change or development in the art

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Congress was very much aware of the potential conflict between federal and state powers and resolved it in favor of the States through the adoption of Section 152(b).11/ As

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requiring new and improved apparatus); and note at pages 19-20, _supra_. The ICC repeatedly recognized the effect on depreciation caused by technological improvements in equipment and efficiency. _Depreciation Charges Of Telephone Companies_, 118 I.C.C. 295, 303 (1926) and 177 I.C.C. 351, 358, 401, 420-1 (1931). _See also Denver v. Denver Union Water Co._, 246 U.S. 178, 191 (1918). Thus, in determining jurisdictional boundaries with respect to "depreciation" it is a reasonable assumption that Congress understood the concept to include the phenomenon of "obsolescence" which is essentially the underlying concern of the FCC in its order on review in this case.

11/ In 1929, Congress had already conducted hearings on a bill to create a federal commission to regulate telephone services, at

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stated by the Senate sponsor, Mr. Dill:

> We have attempted in Title I to reserve to the State Commissions the control of intrastate telephone traffic. We have kept in mind the fact that the Interstate Commerce Commission, through the Shreveport decision and the decisions in similar cases, has gone so far in the regulation of railroads that the so-called "State regulation" amounts to very little.
>
> We have attempted in this proposed legislation, to safeguard State regulation by certain provisions to the effect that where existing intrastate telephone business is being regulated by a State commission, the provisions of the bill shall not apply.

78 Cong. Rec. 8823 (1934). Similarly,

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which time states expressed their concerns and sought Congressional protection for their ability to exercise jurisdiction over intrastate services and depreciation policies. Hearings on S. 6 before the Senate Committee on Interstate Commerce, 71st Cong. 1st and 2d Sess. (1929-30). See Stephan, Federal Regulation of Communications, 1934 Fed. B.A.J. 87.

the Senate Report on the bill states that Section 2 (47 U.S.C. § 152) "reserves to the States exclusive jurisdiction over intrastate telephone and telegraph communication." S.R. No. 781, 73d Cong., 2d Sess. at 3 (1934). The language of Section 2(b), then, strengthened from the proviso in the Interstate Commerce Act, was designed to cut back upon the scope of the federal powers upheld in Shreveport, thereby, at a minimum, preserving State intrastate ratemaking authority intact. Senator Dill's remarks also explain that Section 2(b) was intended to address State concerns over jurisdiction, which, at this period of time, centered most prominently on the ability to regulate depreciation. Further, States were then regulating intrastate depreciation;

therefore the provisions of the proposed Act were "not to apply" to such regulation. The only conclusion which can reasonably be supported from an analysis of the statute and its legislative history is that Congress specifically meant to deprive the FCC of jurisdiction over intrastate rates and services, including depreciation, thereby eliminating any federal threat to the traditional exercise of State regulatory powers.

Such a conclusion is supported by this Court's decision in Federal Power Comm'n v. Conway Corp., 426 U.S. 271 (1976), interpreting similar provisions in the Federal Power Act, 16 U.S.C. 824a et seq. The Federal Power Commission (FPC) in that case had conducted proceedings to determine the

reasonableness of a requested wholesale rate increase. Intervenors challenged the wholesale increase on the grounds that it would create an "unreasonable difference" between the utility's wholesale and retail rates, in contravention of Section 205(b) of the Power Act, 16 U.S.C. 824d(b). The FPC refused to address intervenor's claim, finding instead that the relief sought was beyond that granted to the FPC by the Act. Id. at 274-5.

In analyzing the issue of the extent of the FPC's authority, the Court noted that the Act only vested federal jurisdiction over wholesale electric sales, based on the plain language of Section 206(a), 16 U.S.C. 824e(a). The Court unanimously found that the FPC has no authority to prescribe the rates for

retail sales of electric companies or to remedy any discrimination between wholesale and retail rates by adjusting retail rates. Id. at 426. In so finding, the Court expressly relied upon the legislative history of Section 205 recognizing that the Section was drafted to avoid the result in Shreveport Cases and to foreclose the possibility of the FPC seeking to rectify alleged discrimination by regulating in any fashion the retail rate. Id. at 277 and note 5. As a result, the FPC's authority was restricted solely to wholesale rates.

Conway is analogous to this case, and supports amici's interpretation of the FCC's power. Section 2(b) of the Communications Act is intended to preserve state ratemaking

power over intrastate telephone service in the same manner and for the same purposes underlying Section 205(b) of the Power Act, as indicated by the reference to the <u>Shreveport Cases</u> in <u>Conway</u>, and the discussion at pages 56-57, <u>supra</u>. The effect of the two provisions is also identical: to preserve to the states the regulatory authority over telephone and electric utilities which they were exercising prior to the passage of the federal Acts in 1934 and 1935. For electric utilities this means retail rates and services; for telephone utilities, intrastate rates and services.

The FCC has, until the order on review in this case, acquiesced in State regulation of intrastate telephone rates, including the determination of

proper depreciation expense for intrastate property, even when such State regulation was inconsistent with its own policies and practices. The agency has also conceded the reasonableness of amici's statutory interpretation. *In the Matter of Amendment of Part 31, Uniform System of Accounts for Class A and Class B Telephone Companies*, 89 F.C.C.2d 1094 (1982) *rev'd*. C.C. Dkt. 79-105 (F.C.C. January 6, 1983). Such consistent FCC action with respect to its jurisdiction is persuasive in ascertaining the proper scope and intent of the Act. *Puerto Rico Telephone Co. v. F.C.C.*, 553 F.2d 694, 699 (1st Cir. 1977); *North Carolina Utilities Commission v. F.C.C.*, 537 F.2d 787, 794 (4th Cir.) *cert. denied* 429 U.S. 1027 (1976). An

agency's long-standing interpretation of its enabling legislation deserves considerable deference in the absence of legislative action to the contrary. Udall v. Tallman, 380 U.S. 1, 16 (1965). In particular, nonaction by the FCC for such a long period of time is indicative of a lack of statutory power. As stated in Federal Trade Comm'n. v. Bunte Bros., Inc., 312 U.S. 349, 352 (1941),

> [J]ust as established practice may shed light on the extent of power conveyed by general statutory language, so the want of assertion of power by those who presumably would be alert to exercise it, is equally significant in determining whether such power was actually conferred.

Moreover, it is likely that Congress was aware of the FCC's failure to exercise jurisdiction over intrastate depreciation and continued state regulation thereof, especially in the

years immediately after the Act took effect when the treatment of depreciation was still a hotly disputed issue. If Congress had intended for the FCC to displace state regulation in this respect, it could have amended the Act to clarify its intent. Congress has, on three occasions, already amended Section 2(b) of the Act to alter the appropriate scope of state jurisdiction. See 47 U.S.C.A. § 152(b) (1985). The FCC's interpretation through acquiescence in state regulation for almost 50 years belies its subsequent position on review here, and Congress' "failure to repeal or revise [the Act or relevant provisions] in the face of such administrative interpretation [is] persuasive evidence that the interpretation is the one intended by

Congress." CBS, Inc. v. FCC, 453 U.S. 267, 285 (1981) (quoting Zemel v. Rusk, 381 U.S. 1, 11 (1965)). See, Grove City College v. Bell, ___ U.S. ___, 104 S. Ct. 1211 (1984); Merrill Lynch, Pierce, Fenner & Smith v. Curran, 456 U.S. 353 (1982).

CONCLUSION

For these reasons, as well as for the reasons set forth in Petitioners' brief, amici request this Court to reverse the decision below.

Respectfully submitted,

By: ______________________
J. DAVID MCNEILL III
Counsel of Record
Assistant Attorney General
7434 Perkins Road
Baton Rouge, Louisiana 70808
Telephone: (504) 922-0187

JOHN L. GUBBINS
JEFFREY C. PAULSON
John Gubbins, Ltd.
20 North Clark Street, Suite 2600
Chicago, Illinois 60602
Illinois Citizens Utility Board
108 North State Street
Chicago, Illinois 60602

JOEL BLAU
PHILIP S. SHAPIRO
New York State Consumer Protection
Board, Utility Intervention Unit
99 Washington Avenue, Suite 1020
Albany, New York 12210

BARRY ZITSER
Consumer Counsel of the
Connecticut Division of
Consumer Counsel
One Central Park Plaza, Room 105
New Britian, Connecticut 06051

CORRINE K. A. WATANABE
Attorney General
State of Hawaii
RONALD SHIGEKANE
Deputy Attorney Genera
Consumer Advocate, Di tor of
Department of Commerce
and Consumer Affairs
State Capitol
Honolulu, Hawaii 96813

BRIAN BURNETT
Assistant Attorney General
Utah Attorney General's Office
130 State Capitol Building
Salt Lake City, Utah 84114
Utah Committee of Consumer Services
408 Heber M. Wells Building
160 East 300 South
Salt Lake City, Utah 84145

APPENDIX

AN ACT to add Article XIII to "An Act concerning public utilities", approved June 29, 1921, as amended, and to amend Section 4.3 of the "Regulatory Agency Sunset Act", approved September 22, 1979, as amended.

Be it enacted by the People of the State of Illinois, represented in the General Assembly:

Section 1. Article XIII is added to "An Act concerning public utilities", approved June 29, 1921, as amended, the added Article to read as follows:

ARTICLE XIII. TELECOMMUNICATIONS

(Ch. 111 2/3, new par. 13-100)

Sec. 13-100. This Article shall be known and may be cited as the Universal Telephone Service Protection Law of 1985.

(Ch. 111 2/3, new par. 13-101)

Sec. 13-101. Except to the extent modified or supplemented by the specific provisions of this Article, the Sections of this Act pertaining to public utilities, public utility rates and services, and the regulation thereof, are fully and equally applicable to noncompetitive telecommunications rates and services, and the regulation thereof, except where the context clearly renders such provisions inapplicable. Except to the extent modified or supplemented by the specific provisions of this Article, Articles I through V, Sections 9-221, 9-222 and 9-250, Articles X and XI of this Act are fully and equally applicable to competitive telecommunications service, competitive telecommunications rates and services, and the regulation thereof.

(Ch. 111 2/3, new par. 13-102)

Sec. 13-102. With respect to telecommunications services, as herein defined, the General Assembly finds that:

(a) universally available and widely affordable telecommunications services are essential to the health, welfare and prosperity of all Illinois citizens;

(b) recent federal regulatory and judicial rulings have caused a restructuring of the telecommunications industry and have opened some aspects of the industry to competitive entry, thereby necessitating revision of State telecommunications regulatory policies and practices;

(c) the competitive offering of telecommunications services may create the potential for increased innovation and efficiency in the provision of telecommunications services and reduced prices for consumer; and

(d) protection of the public interest requires continued regulation of telecommunications carriers and services for the foreseeable future.

(Ch. 111 2/3, new par. 13-103)

Sec. 13-103. Consistent with its findings, the General Assembly declares that it is the policy of the State of Illinois that

(a) telecommunications services should be available to all Illinois citizens at just, reasonable and affordable rates and that such services should be provided as widely and economically as possible in sufficient variety, quality, quantity and reliability to satisfy the public interest;

(b) when consistent with the protection of consumers of telecommunications services and the furtherance of other public interest goals, competition should be permitted to function as a substitute for certain aspects of regulation in determining the variety, quality and price of telecommunications services and that the economic burdens of regulation should be reduced to the extent possible consistent with protection of the public interest;

(c) all necessary and appropriate modifications to State regulation of telecommunications carriers and services should be implemented without unnecessary disruption to the telecommunications system or to consumers of telecommunications services and that it is necessary and appropriate to establish a reasonable period of time to permit preparation for orderly transitions in the provision of telecommunications services;

(d) the consumers of telecommunications services and facilities provided by persons or companies subject to regulation pursuant to this Act and Article should be required to pay only reasonable and non-discriminatory rates or charges and that in no case should rates or charges for non-competitive telecommunications services include any portion of the cost of providing competitive telecommunications services, as herein defined;

(e) the regulatory policies and procedures provided in this Article are established in recognition of the changing nature of the telecommunications industry and therefore should be subject to systematic legislative review to ensure that the public benefits intended to result from such policies and procedures are fully realized.

(Ch. 111 2/3, new par. 13-201)

Sec. 13-201. Unless otherwise specified, the terms set forth in Section 13-202 through 13-211 of this Article are used in this Act and Article as herein defined.

(Ch. 111 2/3, new par. 13-202)

Sec. 13-202. "Telecommunications carrier" means and includes every corporation, company, association, joint stock company or association, firm, partnership or individual, their lessees, trustees or receivers appointed by any court whatsoever that owns, controls, operates or manages, within this

State, directly or indirectly, for public use, any plant, equipment or property used or to be used for or in connection with, or owns or controls any franchise, license, permit or right to engage in the provision of, telecommunications services between points within the State which are specified by the user. Telecommunications carrier does not include, however:

(a) telecommunications carriers that are owned and operated by any political subdivision, public or private institution of higher education or municipal corporation of this State, for their own use, or telecommunications carriers that are owned by such political subdivision, public or private institution of higher education, or municipal corporation and operated by any of its lessees or operating agents, for their own use;

(b) telecommunications carriers which are purely mutual concerns, having no rates or charges for services, but paying the operating expenses by assessment upon the members of such a company and no other person but does include telephone or telecommunications cooperatives as defined in Section 13-212;

(c) a company or person which provides telecommunications services solely to itself and its affiliates or members or between points in the same building, or between closely located buildings, affiliated through substantial common ownership, control or development.

(Ch. 111 2/3, new par. 13-203)

Sec. 13-203. "Telecommunications service" means the provision or offering for rent, sale or lease, or in exchange for other value received, of the transmittal of information, by means of electromagnetic, including light, transmission with or without benefit of any closed transmission medium, including all instrumentalities, facilities, apparatus, and services

(including the collection, storage, forwarding, switching, and delivery of such information) used to provide such transmission.

"Telecommunications service" does not include, however:

(a) the rent, sale, or lease, or exchange for other value received, of customer premises equipment;

(b) telephone or telecommunications answering services, paging services, and physical pickup and delivery incidental to the provision of information transmitted through electromagnetic, including light, transmission;

(c) community antenna television service which is operated to perform for hire the service of receiving and distributing video and audio program signals by wire, cable or other means to members of the public who subscribe to such service, to the extent that such service is utilized solely for the one-way distribution of such entertainment services with no more than incidental subscriber interaction required for the selection of such entertainment service.

The Commission may, by rulemaking, exclude (1) private line service which is not directly or indirectly used for the origination or termination of switched telecommunications service, (2) cellular radio service, (3) high-speed point-to-point data transmission at or above 9.6 kilobits, or (4) the provision of telecommunications service by a company or person otherwise subject to Section 13-202 (c) to a telecommunications carrier, which is incidental to the provision of service subject to Section 13-202 (c), from active regulatory oversight to the extent it finds, after notice, hearing and comment that such exclusion is consistent with the public interest and the purposes and policies of this Article.

(Ch. 111 2/3, new par. 13-204)

Sec. 13-204. "Local Exchange Telecommunications Service" means telecommunications service between points with-

in an exchange, as defined in Section 13-206, or the provision of telecommunications service for the origination or termination of switched telecommunications services.

(Ch. 111 2/3, new par. 13-205)

Sec. 13-205. "Interexchange Telecommunications Service" means telecommunications service between points in two or more exchanges.

(Ch. 111 2/3, new par. 13-206)

Sec. 13-206. "Exchange" means a geographical area for the administration of telecommunications services, established and described by the tariff of a telecommunications carrier providing local exchange telecommunications service, and consisting of one or more contiguous central offices, together with associated facilities used in providing such local exchange telecommunications service. To the extent practicable, a municipality, city or village shall not be located in more than one exchange.

(Ch. 111 2/3, new par. 13-207)

Sec. 13-207. "Local Access and Transport Area (LATA)" means a geographical area designated by the Modification of Final Judgment in U.S. v. Western Electric Co., Inc., 552 F. Supp. 131 (D.D.C. 1982), as modified from time to time.

(Ch. 111 2/3, new par. 13-208)

Sec. 13-208. "Market Service Area (MSA)" means a geographical area consisting of one or more exchanges, defined by the Commission for the administration of tariffs, services and other regulatory obligations. The term Market Service Area includes those areas previously designated by the Commission.

(Ch. 111 2/3, new par. 13-209)

Sec. 13-209. "Competitive Telecommunications Service" means a telecommunications service, its functional equivalent

or a substitute service, which, for some identifiable class or group of customers in an exchange, group of exchanges, or some other clearly defined geographical area, is reasonably available from more than one provider, whether or not such provider is a telecommunications carrier subject to regulation under this Act. A telecommunications service may be competitive for the entire state, some geographical area therein, including an exchange or set of exchanges, or for a specific customer or class or group of customers, but only to the extent consistent with this definition.

(Ch. 111 2/3, new par. 13-210)

Sec. 13-210. "Noncompetitive Telecommunications Service" means a telecommunications service other than a competitive service as defined in Section 13-209.

(Ch. 111 2/3, new par. 13-211)

Sec. 13-211. "Resale of Telecommunications Service" means the offering or provision of telecommunications service primarily through the use of services or facilities owned or provided by a separate telecommunications carrier.

(Ch. 111 2/3, new par. 13-212)

Sec. 13-212. "Telephone or Telecommunications Cooperative" means any Illinois corporation organized on a cooperative basis for the furnishing of telephone or telecommunications service.

(Ch. 111 2/3, new par. 13-301)

Sec. 13-301. Consistent with the findings and policy established in paragraph (a) of Section 13-102 and paragraph (a) of Section 13-103, and in order to ensure the attainment of such policies, the Commission shall

(a) participate in all federal programs intended to preserve or extend universal telecommunications service, unless such programs would place cost burdens on Illinois customers

of telecommunications services in excess of the benefits they would receive through participation; and shall report on such programs together with an assessment of their adequacy and the advisability of participating therein in its annual report to the General Assembly, or more often as necessary;

(b) establish a program to monitor the level of telecommunications subscriber connection within each exchange in Illinois, and shall report the results of such monitoring and any actions it has taken or recommends be taken to maintain and increase such levels in its annual report to the General Assembly, or more often if necessary;

(c) order all telecommunications carriers offering or providing local exchange telecommunications service to propose low-cost or budget service tariffs and any other rate design or pricing mechanisms designed to facilitate customer access to such telecommunications service, and shall after notice and hearing, implement any such proposals which it finds likely to achieve such purpose;

(d) investigate the necessity and feasibility of establishing a fund from which telecommunications carriers offering or providing local exchange telecommunications service, whose costs of providing such service exceed the average cost of providing such service in Illinois, could receive revenues intended to mitigate the price impact on customers resulting from the high or rising cost of such service; and shall include the results and findings of such investigation together with any recommendations for legislative action in its first annual report to the General Assembly in 1986;

(e) Any telecommunications carrier providing local exchange telecommunications service which offers to its local exchange customers a choice of two or more local exchange telecommunications service offerings shall provide, to any such customer requesting it, once a year without charge, a report describing which local exchange telecommunications service offering would result in the lowest bill for such customer's local exchange service, based on such customer's calling pattern and usage for the previous 6 months. At least once a year, each such carrier shall provide a notice to each of its local exchange telecommunications service customers describing the availability of this report and the specific procedures by which customers may receive it. Such report shall only be available to current and future customers who have received at least 6 months of continuous local exchange service from such carrier.

(Ch. 111 2/3, new par. 13-401)

Sec. 13-401. (a) No telecommunications carrier not possessing a certificate of public convenience and necessity or certificate of authority from the Commission at the time this Article goes into effect shall transact any business in this State until it shall have obtained a certificate of service authority from the Commission pursuant to the provisions of this Article.

No telecommunications carrier offering or providing, or seeking to offer or provide, any interexchange telecommunications service shall do so until it has applied for and received a Certificate of Interexchange Service Authority pursuant to the provisions of Section 13-403. No telecommunications carrier offering or providing, or seeking to offer or provide, any local exchange telecommunications service shall do so until it has applied for and received a Certificate of Exchange Service Authority pursuant to the provisions of Section 13-405.

No Certificate of Service Authority issued by the Commission shall be construed as granting a monopoly or exclusive

privilege, immunity or franchise. The issuance of a Certificate of Service Authority to any telecommunications carrier shall not preclude the Commission from issuing additional Certificates of Service Authority to other telecommunications carriers providing the same or equivalent service or serving the same geographical area or customers as any previously certified carrier, except to the extent otherwise provided by Sections 13-403 and 13-405.

Any certificate of public convenience and necessity granted by the Commission to a telecommunications carrier prior to the effective date of this Article shall remain in full force and effect, and such carriers need not apply for a Certificate of Service Authority in order to continue offering or providing service to the extent authorized in such certificate of public convenience and necessity. Any such carrier, however, prior to substantially altering the nature or scope of services provided under a certificate of public convenience and necessity, or adding or expanding services beyond the authority contained in such certificate, must apply for a Certificate of Service Authority for such alterations or additions pursuant to the provisions of this Article.

The Commission shall review and modify the terms of any certificate of public convenience and necessity issued to a telecommunications carrier prior to the effective date of this Article in order to ensure its conformity with the requirements and policies of this Article. Any Certificate of Service Authority may be altered or modified by the Commission, after notice and hearing, upon its own motion or upon application of the person or company affected. Unless exercised within a period of two years from the issuance thereof, authority conferred by a Certificate of Service Authority shall be null and void.

(b) The Commission may issue a temporary Certificate which shall remain in force not to exceed one year in cases of emergency, to assure maintenance of adequate service or to serve particular customers, without notice and hearing, pending the determination of an application for a Certificate, and may by regulation exempt from the requirements of this Section temporary acts or operations for which the issuance of a certificate is not necessary in the public interest and which will not be required therefor.

(Ch. 111 2/3, new par. 13-402)

Sec. 13-402. The Commission is authorized, in connection with the issuance or modification of a Certificate of Interexchange Service Authority or the modification of a certificate of public convenience and necessity for interexchange telecommunications service, to waive or modify the application of its rules, general orders, procedures or notice requirements when such action will reduce the economic burdens of regulation and such waiver or modification is not inconsistent with the law or the purposes and policies of this Article.

Any such waiver or modification granted to any interexchange telecommunications carrier which has, or any group of such carriers any one of which has annual revenues exceeding $10,000,000 shall be automatically applied fully and equally to all such carriers with annual revenues exceeding $10,000,000 unless the Commission specifically finds, after notice to all such carriers and a hearing, that restricting the application of such waiver or modification to only one such carrier or some group of such carriers is consistent with and would promote the purposes and policies of this Article and the protection of telecommunications customers.

(Ch. 111 2/3, new par. 13-403)

Sec. 13-403. The Commission shall approve an application for a Certificate of Interexchange Service Authority only

upon a showing by the applicant, and a finding by the Commission, after notice and hearing, that the applicant possesses sufficient technical, financial and managerial resources and abilities to provide interexchange telecommunications service. The Commission shall not issue a Certificate of Interexchange Service Authority to more than one facilities-based, interexchange telecommunications carrier for the offer or provision of any intra-Market Service Area interexchange telecommunications service prior to January 1, 1987.

The Commission shall not permit any telecommunications carrier providing interexchange telecommunications service to use intra-Market Service Area dialing arrangements in place July 1, 1985 which do not require the use of telecommunications carrier-specific access codes unless such carrier is also properly certified to offer or provide facilities-based local exchange telecommunications service, prior to a legislative determination to the contrary. The Commission shall conduct a study, and, after notice and hearing, issue a report with findings and recommendations concerning the advisability of permitting a change in the use of such dialing arrangements. Such report shall be submitted to the General Assembly on October 1, 1988.

The Commission shall have authority to alter the boundaries of Market Service Areas when such alteration is consistent with the public interest and the purposes and policies of this Article, provided however, that no significant alteration in such boundaries shall take place prior to January 1, 1987 and no such alteration shall affect the dialing arrangements specified in the immediately preceding paragraph of this Section. A determination by the Commission with respect to Market Service Area boundaries shall not modify or affect the rights or obligations of any telecommunications carrier with respect to any consent decree or agreement with the United States Department of Justice, including, but not limited to, the Modification of Final Judgment in United States v. Western Electric Co., 552 F. Supp. 131 (D.C.C. 1982), as modified from time to time.

(Ch. 111 2/3, new par. 13-404)

Sec. 13-404. Any telecommunications carrier offering or providing the resale of either local exchange or interexchange telecommunications service must first obtain a Certificate of Service Authority. The Commission shall approve an application for a Certificate for the resale of local exchange or interexchange telecommunications service upon a showing by the applicant, and a finding by the Commission, after notice and hearing, that the applicant possesses sufficient technical, financial and managerial resources and abilities to provide the resale of telecommunications service.

(Ch. 111 2/3, new par. 13-405)

Sec. 13-405. The Commission shall approve an application for a Certificate of Exchange Service Authority only upon a showing by the applicant, and a finding by the Commission, after notice and hearing, that

(a) the applicant possesses sufficient technical, financial and managerial resources and abilities to provide local exchange telecommunications service;

(b) that the exercise of the Certificate's authority by the applicant would not adversely affect prices, network design, or the financial viability of the principal provider of local exchange telecommunications service.

The Commission shall not approve or issue a Certificate of Exchange Service Authority to more than one telecommunications carrier for any exchange prior to January 1, 1989; provided, however, that a Certificate of Exchange Service Au-

thority may be issued before such time, subject to appropriate Commission approval, pursuant to this Section, to any telecommunications carrier providing predominantly direct nonswitched access service between a customer or user and any telecommunications carrier providing inter-MSA, inter-LATA or inter-state telecommunications service, or between such telecommunications carriers, for the purpose of providing such direct access service.

(Ch. 111 2/3, new par. 13-406)

Sec. 13-406. No telecommunications carrier offering or providing noncompetitive telecommunications service pursuant to a valid Certificate of Service Authority or certificate of public convenience and necessity shall discontinue or abandon such service once initiated until and unless it shall demonstrate, and the Commission finds, after notice and hearing, that such discontinuance or abandonment will not deprive customers of any necessary or essential telecommunications service or access thereto and is not otherwise contrary to the public interest. No telecommunications carrier offering or providing competitive telecommunications service shall discontinue or abandon such service once initiated except upon 30 days notice to the Commission and affected customers. The Commission may, upon its own motion or upon complaint, investigate the proposed discontinuance or abandonment of a competitive telecommunications service and may, after notice and hearing, prohibit such proposed discontinuance or abandonment if the Commission finds that it would be contrary to the public interest.

(Ch. 111 2/3, new par. 13-407)

Sec. 13-407. The Commission shall monitor and analyze patterns of entry and exit, and applications for entry and exit, for each relevant market for telecommunications services

and shall include its findings together with appropriate recommendations for legislative action in its annual report to the General Assembly.

(Ch. 111 2/3, new par. 13-501)

Sec. 13-501. No telecommunications carrier shall offer or provide telecommunications service unless and until a tariff is filed with the Commission which describes the nature of the service, applicable rates and other charges, terms and conditions of service, and the exchange, exchanges or other geographical area or areas in which the service shall be offered or provided. The Commission may prescribe the form of such tariff and any additional data or information which shall be included therein.

(Ch. 111 2/3, new par. 13-502)

Sec. 13-502. (a) All telecommunications services offered or provided under tariff by telecommunications carriers shall be classified as either competitive or noncompetitive. A telecommunications carrier may offer or provide either competitive or noncompetitive telecommunications services, or both, subject to proper certification and other applicable provisions of this Article. Any tariff filed with the Commission as required by Section 13-501 shall indicate whether the service to be offered or provided is competitive or noncompetitive.

(b) A service shall be classified as competitive only if, and only to the extent that, for some identifiable class or group of customers in an exchange, group of exchanges, or some other clearly defined geographical area, such service, or its functional equivalent, or a substitute service, is reasonably available from more than one provider, whether or not any such provider is a telecommunications carrier subject to regulation under this Act. All telecommunications services not properly classified as competitive shall be classified as non-

competitive. The Commission shall have the power to investigate the classification of telecommunication service, on its own motion or upon complaint, and to modify such classification or reclassify any service, in whole or in part, after notice and hearing. If, upon such motion or complaint, the Commission enters into a hearing or investigation upon the propriety of any service classification pursuant to this Section, the Commission shall make its determination and issue its final order no later than 120 days from the date such hearing or investigation is initiated.

(c) No tariff classifying a new telecommunications service as competitive or reclassifying a previously noncompetitive telecommunications service as competitive, which is filed by a telecommunications carrier which also offers or provides noncompetitive telecommunications service, shall be effective unless and until such telecommunications carrier offering or providing, or seeking to offer or provide, such proposed competitive service prepares and files a study of the long-run marginal cost underlying such service. Such study shall be given proprietary treatment by the Commission at the request of such carrier if any other provider of the competitive service, its functional equivalent, or a substitute service in the geographical area described by the proposed tariff has not filed, or has not been required to file, such a study.

(d) In the event any telecommunications service has been classified and filed as competitive by the telecommunications carrier, and has been offered or provided on such basis, and the Commission subsequently determines after investigation that such classification improperly included services which were in fact noncompetitive, the Commission shall have the power to determine and order refunds to customers for any overcharges which may have resulted from the improper

classification, or to order such other remedies provided to it under this Act, or to seek an appropriate remedy or relief in a court of competent jurisdiction.

(e) Any telecommunications carrier which seeks to file a tariff classifying a new telecommunications service as competitive or reclassifying a previously noncompetitive telecommunications service as competitive may, instead of filing such new tariff and offering and providing such service as competitive subject to refund, apply to the Commission, prior to offering or providing such service as competitive, for an order finding that the proposed tariff is proper and consistent with law. Provided, however, that prior to August 1, 1987 any telecommunications carrier which seeks to file a tariff classifying a new interexchange telecommunications service as competitive or reclassifying a previously noncompetitive interexchange telecommunications service as competitive shall apply for prior Commission approval of such tariff pursuant to the procedures of this paragraph (e). Any telecommunications carrier applying for Commission approval pursuant to this paragraph (e) shall provide timely and effective notice of its application and proposed tariff to potentially affected providers and customers in a manner to be determined by the Commission.

Upon such application and notice, the Commission may make its findings without hearing within 21 days of the filing of the application and may allow such tariff to take immediate effect thereafter if there is no request for hearing by potentially affected providers or customers. The Commission shall, however, enter into hearings to determine the propriety and legality of the proposed tariffs upon such request or if the Commission, in its discretion, believes such hearings are necessary.

If the Commission enters into hearings upon the application, it shall issue a final order within 120 days of such application, and, if the Commission fails to issue an order within such period, the application shall be deemed granted, unless, however, the Commission, the applicant and all parties to the hearing agree to extend such time period. The Commission shall have the power to issue an interim order allowing the proposed tariff to take effect during the 120 day period subject to refund and such other conditions as the Commission may provide.

(Ch. 111 2/3, new par. 13-503)

Sec. 13-503. With respect to rates or other charges made, demanded or received for any telecommunications service offered, provided or to be provided, whether such service is competitive or noncompetitive, telecommunications carriers shall comply with the publication and filing provisions of Sections 9-101, 9-102, and 9-103.

(Ch. 111 2/3, new par. 13-504)

Sec. 13-504. Except where the context clearly renders such provisions inapplicable, the ratemaking provisions of Article IX of this Act relating to public utilities are fully and equally applicable to the rates, charges, tariffs and classifications for the offer or provision of noncompetitive telecommunications services. Provided, however, that such ratemaking provisions do not apply to any proposed change in rates or charges, or proposed change in any classification or tariff resulting in a change in rates or charges, for a noncompetitive local exchange telecommunications service offered or provided by a local exchange telecommunications carrier with no more than 15,000 subscriber access lines, where such carrier is also not a subsidiary of a holding company incorporated outside Illinois. Proposed changes in rates, charges, classifications, or

tariffs meeting these criteria shall be permitted upon the filing of the proposed tariff and 30 days notice to the Commission and all potentially affected customers; such proposed changes shall not be subject to suspension, but the Commission may, upon its own motion or upon complaint, investigate whether such proposed change is just and reasonable and if it finds, after notice and hearing, that such changes are unjust or unreasonable, in whole or in part, the Commission shall have the power and duty to establish the rates, charges, classifications, or tariffs it finds to be just and reasonable. The Commission shall investigate whether any such proposed change is just and reasonable if 5 percent or more of the potentially affected access line subscribers of the telecommunications carrier file a petition or complaint requesting such investigation.

(Ch. 111 2/3, new par. 13-505)

Sec. 13-505. Proposed changes in rates or charges, or any classification or tariff provision affecting rates or charges, for any competitive telecommunications service, shall be treated pursuant to this Section as follows;

(a) any proposed decrease in rates or charges, or proposed change in any classification or tariff resulting in a decrease in rates or charges, for competitive local exchange or interexchange telecommunications service shall be permitted upon the filing of the proposed rate, charge, classification or tariff;

(b) any proposed increase in rates or charges, or proposed change in any classification or tariff resulting in an increase in rates or charges, for a competitive interexchange telecommunications service shall be permitted only upon the filing of the proposed rate, charge, classification or tariff and upon notice to all potentially affected customers through a notice

in each such customer's bill prior to the date for implementation of such increase or change, or, where such customers are not billed, by an equivalent means of prior notice;

(c) any proposed increase in rates or charges, or proposed change in any classification or tariff resulting in an increase in rates or charges, for a competitive local exchange telecommunications service shall be treated as though such service were noncompetitive, pursuant to the applicable provisions of Section 13-504.

(Ch. 111 2/3, new par. 13-506)

Sec. 13-506. (a) Telecommunications carriers may file proposed tariffs for any competitive local exchange telecommunications service, which includes and specifically describes a range, band, formula, or standard within or by which a change in rates or charges for such telecommunications service could be made without prior notice or prior Commission approval. The Commission shall approve such a proposed tariff only if the telecommunications carrier demonstrates, and the Commission finds, that any and all rates or charges within the band or range, or determinable by the operation of the formula or standard, are consistent with the public interest and the purposes and policies of this Article and Act, and are likely to remain so for the foreseeable future. To the extent any proposed band or range encompasses rates or charges which are not consistent with the public interest and the purposes and policies of this Article and Act or otherwise fully proper, or any proposed formula or standard determines rates or charges which are not consistent with the purposes and policies of this Article and Act or fully proper, the Commission shall have the power to modify the level, scope or limits of such band or range, and to modify or limit the operation of such formula or standard, as necessary, to ensure that

rates or charges resulting therefrom are consistent with the purposes and policies of this Article and Act and fully proper, and likely to remain so in the foreseeable future.

(b) The Commission may require a telecommunications carrier to file a variable tariff as described in paragraph (a) for any or all competitive local exchange telecommunications service which is offered or provided by such carrier, if the Commission finds, after notice and hearing, that the determination of rates or charges for such service by such a tariff would improve the Commission's ability to effectively regulate such rates or charges and that such improvement is required by the public interest. Any such tariff required by the Commission shall be approved only if it is also consistent with the provisions of paragraph (a) of this Section.

(c) When the Commission approves a variable tariff pursuant to this Section, as proposed or modified, the telecommunications carrier shall place such tariff in effect thereafter and shall determine rates or charges according to the provisions thereof.

(Ch. 111 2/3, new par. 13-507)

Sec. 13-507. In permitting, approving, investigating or establishing rates, charges, classifications or tariffs for noncompetitive services offered or provided by a telecommunications carrier which also offers or provides competitive services, the Commission shall not allow or establish rates, charges, classifications or tariffs which in any way, directly or indirectly, include or reflect:

(a) the value of investment in facilities used, jointly or separately, to provide competitive service, to the extent such facilities are used to provide competitive service;

(b) expenses incurred for the provision of competitive service, including, but not limited to, the salaries or wages,

or portion thereof, of employees whose employment activities are directed, in whole or in part, to the provision of competitive service, to the extent such expenses are incurred to provide competitive service;

(c) any incremental risk or increased cost of capital which is associated with or attributable to the competitive portion of such carrier's business.

In the event that facilities are utilized or expenses are incurred for the provision of both competitive and noncompetitive services, the Commission shall allow or establish rates or charges for the noncompetitive services which reflect only that portion of such facilities or expenses properly and reasonably allocable to the noncompetitive services. Every telecommunications carrier shall, to the fullest extent practicable, identify such common facilities and expenses in its books and accounts and shall clearly describe any means used to allocate such common facilities or expenses between noncompetitive and competitive services and related rates or charges. If the Commission determines that such accounting and reporting requirements alone are insufficient to permit the Commission to meet the ratemaking and tariff supervision obligations of this Section, it shall have the power to take or require such additional action as necessary to ensure that rates or charges for noncompetitive services reflect only the value of facilities, or portion thereof, used and useful, and the expenses or portion thereof reasonably and prudently incurred, for the provision of such noncompetitive services. The Commission shall, in such event, also establish, by rule, any additional accounting or reporting procedures, rules, regulations or mechanisms necessary to identify and properly allocate the value or amount of such facilities or expenses.

For the purposes of this Section, the Commission shall not allocate to any competitive service all or part of the value of

investment in facilities utilized, or expenses incurred, in connection with providing noncompetitive service.

The Commission may establish, by rule, appropriate methods for calculating the long-run marginal costs of providing any telecommunications service, and for determining whether the rates or charges for telecommunications service are at a level equal to or greater than such long-run marginal cost. The Commission may order any telecommunications carrier to conduct a long-run marginal cost study and to provide the results thereof to the Commission. Any cost study provided to the Commission pursuant to the provisions of this Section may, in the Commission's discretion, be accorded proprietary treatment.

(Ch. 111 2/3, new par. 13-508)

Sec. 13-508. The Commission is authorized, after notice and hearing, to order a telecommunications carrier which offers or provides both competitive and noncompetitive telecommunications service to establish a fully separated subsidiary to provide all or part of such competitive service where:

(a) no less costly means is available and effective in fully and properly identifying and allocating costs between such carrier's competitive and noncompetitive telecommunications services; and

(b) the incremental cost of establishing and maintaining such subsidiary would not require increases in rates or charges to levels which would effectively preclude the offer or provision of the affected competitive telecommunications service.

(Ch. 111 2/3, new par. 13-509)

Sec. 13-509. A telecommunications carrier offering or providing competitive telecommunications service may negotiate with customers or prospective customers for the provision by it of such service, and in so doing, may offer or agree to pro-

vide such service on such terms and for such rates or charges as it deems reasonable, without regard to any tariffs it may have filed with the Commission with respect to such services. Within 10 days after concluding any such agreement, the telecommunications carrier shall file any contract or memorandum of understanding for the provision of telecommunications service, which shall include the rates or other charges, practices, rules or regulations applicable to the agreed provision of such service. Upon filing its contract or memorandum the telecommunications carrier shall thereafter provide service according to the terms thereof, unless the Commission finds, after notice and hearing, that the continued provision of service pursuant to such contract or memorandum would substantially and adversely affect the financial integrity of the telecommunications carrier or would cause the cross-subsidization of any competitive service by any noncompetitive service.

Any contract or memorandum entered into and filed pursuant to the provisions of this Section may, in the Commission's discretion, be accorded proprietary treatment.

(Ch. 111 2/3, new par. 13-601)

Sec. 13-601. The provisions of Article VII of this Act are fully applicable only to telecommunications carriers offering or providing noncompetitive telecommunications service, and the Commission's regulation thereof, except that the approval of contracts and arrangements with affiliated interests required by paragraph (3) of Section 7-101 shall not apply to such contracts or arrangements by such telecommunications carriers where the total obligation thereunder does not exceed the lesser of 1 million dollars or 5 percent of such carrier's prior annual revenue from noncompetitive services.

(Ch. 111 2/3, new par. 13-701)

Sec. 13-701. Notwithstanding any other provision of this Act to the contrary, the Commission has no power to super-

vise or control any telephone cooperative as respects assessment schedules or local service rates made or charged by such a cooperative on a nondiscriminatory basis. In addition, the Commission has no power to inquire into, or require the submission of, the terms, conditions or agreements by or under which telephone cooperatives are financed. A telephone cooperative shall file with the Commission either a copy of the annual financial report required by the Rural Electrification Administration, or the annual financial report required of other public utilities.

(Ch. 111 2/3, new par. 13-702)

Sec. 13-702. Every telecommunications carrier operating in this State shall receive, transmit and deliver, without discrimination or delay, the conversations, messages or other transmissions of every other telecommunications carrier with which a joint rate has been established or with whose line a physical connection may have been made.

(Ch. 111 2/3, new par. 13-703)

Sec. 13-703. (a) The Commission shall design and implement a program whereby each telecommunications carrier providing local exchange service shall provide a telecommunications device capable of servicing the needs of the deaf or severely hearing-impaired together with a single party line, at no charge additional to the basic exchange rate, to any subscriber who is certified as deaf or severely hearing-impaired by a licensed physician, audiologist or a qualified State agency and to any subscriber which is an organization representing the deaf or severely hearing-impaired as determined and specified by the Commission pursuant to subsection (d).

(b) The Commission shall design and implement a program, whereby each telecommunications carrier providing

local exchange service shall provide a dual party system, using third party intervention to connect deaf or severely hearing-impaired persons and offices of organizations representing the deaf or severely hearing-impaired as determined and specified by the Commission pursuant to subsection (d) with persons of normal hearing by way of intercommunications devices for the deaf or severely hearing-impaired and the telephone system, making available reasonable access to all phases of public telephone service to deaf or severely hearing-impaired telephone subscribers. In order to design a dual party relay system which will meet the requirements of deaf and severely hearing-impaired persons available at a reasonable cost the Commission shall initiate an investigation and conduct public hearings to determine the most cost-effective method of providing dual party relay service to the deaf or severely hearing-impaired when using telecommunications devices and therein solicit the advice, counsel, and physical assistance of Statewide nonprofit consumer organizations of the deaf in such hearings and during the development and implementation of the system. The Commission shall phase in this program, on a geographical basis, over a 3-year period ending January 1, 1989.

(c) The commission shall establish a rate recovery mechanism, which shall not exceed 3¢ per month for each line of a subscriber to allow telecommunications carriers providing local exchange service to recover costs as they are incurred under this Section.

(d) The Commission shall determine and specify those Statewide organizations representing the deaf or severely hearing-impaired which shall receive a telecommunications device pursuant to subsection (a) or a dual party relay system pursuant to subsection (b), or both, and in which offices the equipment shall be installed in the case of an organization having more than one office. The Commission shall direct the telecommunications carriers subject to its jurisdiction and this Section to comply with its determinations and specifications in this regard.

(Ch. 111 2/3, new par. 13-704)

Sec. 13-704. Each page of a billing statement which sets forth charges assessed against a customer by a telecommunications carrier for telecommunications service shall reflect the telephone number or customer account number to which the charges are being billed.

(Ch. 111 2/3, new par. 13-801)

Sec. 13-801. The Commission shall prepare and issue an annual report on the status of the telecommunications industry and Illinois regulation thereof on January 31 of each year beginning in 1986. Such report shall include:

(a) A review of regulatory decisions and actions from the preceding year and a description of pending cases involving significant telecommunications carriers or issues;

(b) a description of the telecommunications industry and changes or trends therein, including the number, type and size of firms offering telecommunications services, whether or not such firms are subject to State regulation, telecommunications technologies in place and under development, variations in the geographic availability of services and in prices for services, and penetration levels of subscriber access to local exchange service in each exchange and trends related thereto;

(c) the status of compliance by carriers and the Commission with the requirements of this Article;

(d) the effects, and likely effects of Illinois regulatory policies and practices, including those described in this Article, on telecommunications carriers, services and customers;

(e) any recommendations for legislative change which are adopted by the Commission and which the Commission believes are in the interest of Illinois telecommunications customers;

(f) any other information or analysis which the Commission is required to provide by this Article or deems necessary to provide.

The Commission's report shall be filed with the Joint Committee on Legislative Support Services, the Governor, and the Public Counsel and shall be publicly available. The Joint Committee on Legislative Support Services shall conduct public hearings on the report and any recommendations therein.

(Ch. 111 2/3, new par. 13-802).

Sec. 13-802. The Commission shall study the effects on telecommunications carriers, providers and customers and on telecommunications services and prices likely to result from the issuance of multiple Certificates of Service Authority for Intra-Market Service Area and local exchange service.

The Commission shall also study the need to retain mandatory prior Commission approval of tariffs classifying a new interexchange telecommunication service as competitive or reclassifying a previously noncompetitive interexchange telecommunications service as competitive as provided in Section 13-502(a), and the effects of eliminating such mandatory prior approval. Such studies shall include notice and an opportunity for participation and comment by all interested and potentially affected parties. Such studies shall be completed by January, 1987 and a summary thereof, together with any legislative recommendations, shall be included in the Commission's Annual Report due on January 31, 1987.

(Ch. 111 2/3, new par. 13-803)

Sec. 13-803. The provisions of this Article, Sections 13-101 through 13-803 of this Act, are repealed effective December 31, 1991.

Section 2. Section 4.3 of the "Regulatory Agency Sunset Act", approved September 22, 1979, as amended, is amended to read as follows:

(Ch. 127, par. 1904.3)

Sec. 4.3. The following Acts are repealed December 31, 1985:

(Ch. 111, rep. pars. 1601 through 1670)

(1) The "Illinois Barber Law", approved July 18, 1947, as amended.

(Ch. 111, rep. pars. 1801 through 1839)

(2) "The Illinois Beauty Culture Act", approved June 30, 1925, as amended.

((CH. 111 2/3, REP. PARS. 1 THROUGH 95))

((3) "AN ACT CONCERNING PUBLIC UTILITIES", APPROVED JUNE 29, 1924, AS AMENDED.)

(Ch. 111, rep. pars. 2001 through 2040)

(3) ((4)) The "Collection Agency Act", approved September 8, 1974, as amended.

Section 3. This Act takes effect January 1, 1986, except Section 2 and this Section takes effect upon this Act becoming a law.

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Nos. 84-871, 84-889, 84-1054 and 84-1069

IN THE

Supreme Court of the United States

OCTOBER TERM, 1985

LOUISIANA PUBLIC SERVICE COMMISSION, *Appellant*
v.
FEDERAL COMMUNICATIONS COMMISSION and
UNITED STATES OF AMERICA

CALIFORNIA AND PUBLIC UTILITIES COMMISSION
OF CALIFORNIA, *et al.*, *Petitioners*
v.
FEDERAL COMMUNICATIONS COMMISSION and
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PUBLIC UTILITIES COMMISSION OF OHIO, *et al.*, *Petitioners*
v.
FEDERAL COMMUNICATIONS COMMISSION and
UNITED STATES OF AMERICA

FLORIDA PUBLIC SERVICE COMMISSION, *Petitioner*
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FEDERAL COMMUNICATIONS COMMISSION and
UNITED STATES OF AMERICA

On Appeal and On Writs of Certiorari to the United States Court of Appeals for the Fourth Circuit

BRIEF AMICUS CURIAE OF MCI TELECOMMUNICATIONS CORPORATION

LAURENCE H. SILBERMAN*
HENRY D. LEVINE
JOY LEONG KUNSBERG
MORRISON & FOERSTER
2000 Pennsylvania Avenue, N.W.
Washington, D.C. 20006
(202) 887-1500

Attorneys for MCI Telecommunications Corporation

**Counsel of Record*

October 9, 1985

PRESS OF BYRON S. ADAMS, WASHINGTON, D.C. (202) 347-8203

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BRIEF AMICUS CURIAE OF MCI TELECOMMUNICATIONS CORPORATION

INTEREST OF AMICUS CURIAE

MCI Telecommunications Corporation ("MCI"), pursuant to Rule 36 of the Rules of this Court, respectfully submits this brief as amicus curiae in support of respondents the Federal Communications Commission ("FCC" or "the Commission") and the United States of America. Counsel for all parties have consented to the filing of this brief.

MCI is the nation's second largest long-distance telecommunications carrier, providing both interstate and intrastate service. As a common carrier, MCI is subject to the jurisdiction of the FCC under the Communications Act of 1934 and of state regulators in those states where MCI is authorized to offer intrastate service.

In 1969, the FCC authorized MCI to offer communications services between St. Louis and Chicago by means of microwave transmission. Since then, MCI has grown into a multi-billion dollar company which provides a full range of telecommunications services to both residential and business customers in competition with AT&T Communications. MCI is the product of federal policies that promote technological innovation and open competition.

MCI has a direct interest in supporting the FCC's preemptive authority to further the federal policies of modernization and competition as the telecommunications industry enters a new era. This Court's delineation of the FCC's preemptive authority could well have far-reaching effects on

industry trends and regulation of carriers in areas other than depreciation.

MCI also has a specific interest in the local telephone companies' adoption of more accurate depreciation procedures for interstate and intrastate assets. As a long distance carrier, MCI relies upon local telephone companies for access to its customers at both the origination and termination ends of a call.[1] As a major purchaser of "access" from local telephone companies, MCI, like other customers, will be harmed if telephone facilities are allowed to become obsolete due to disincentives created by outmoded depreciation policies. For example, the inferior access that MCI receives from telephone companies through older mechanical "step-by-step" switches — and that MCI's customers experience in the form of extra digits to dial or extraneous background noise or echo — may be substantially improved by the telephone company's installation of electronic switches. To the extent that the equal access provisions of the Modified Final Judgment do not require such improvements,[2] depreciation policies directly affect telephone company incentives to replace older switches.

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[1]A long distance call originates at the caller's instrument and is carried over local telephone company equipment to MCI's terminal. MCI's network then transmits the call to MCI's terminal in the destination city, where it is handed off to the local telephone company at the terminating end, which completes the call to the called party. MCI (and other long distance carriers) must pay "access charges" to the local telephone companies for use of their facilities at the originating and terminating ends of each call.

[2]Appendix to *United States v. American Tel. and Tel. Co.*, 552 F. Supp. 131, 233 (D.D.C. 1982), *aff'd sub nom. Maryland v. United States*, 460 U.S. 1001 (1983) ("Modified Final Judgment" or "MFJ"). Under the MFJ, the Bell Operating Companies must provide to AT&T's competitors access equal in type and quality to that provided AT&T according to a specified timetable. There are exceptions for "nonconforming end offices" (those with less than 10,000 access lines or with switches antecedent to electronic stored program control switches), which collectively account for some 20% of total telephone lines. Moreover, the MFJ's equal access timetable does not apply to independent telephone companies, *i.e.* those in which AT&T never had a majority interest. *See MTS and WATS Market Structure Policies and Requirements*, 50 Fed. Reg. 15,547 (1985) (to be codified at 47 C.F.R. Ch. 1).

SUMMARY OF ARGUMENT

The Communications Act of 1934, 47 U.S.C. §§ 151-609 (1982) (the "Act"), establishes as a federal goal "rapid, efficient, Nation-wide" communications services with "adequate facilities." 47 U.S.C. § 151 (1982). To achieve that goal, the FCC has adopted policies promoting modernization and efficient use of technology. In recent years, dramatic advances in technology have propelled the telecommunications industry far beyond traditional "plain old telephone service." High-speed digital transmission of voice and data is now possible by means of new technologies (*e.g.*, fiber optics). New services (such as computer-to-computer links and cellular radio) are becoming widely available. Competition — and the resulting lower costs and wider range of services — have revitalized the communications industry and contributed to its explosive growth.

Improper regulation can slow the introduction of new technologies and innovative services. State and federal regulators can control the rate of modernization through their power over depreciation rates, which govern the rate of replacement of assets. The original depreciation regulations adopted by the FCC and the States were designed for a monopoly era characterized by slow technological change. Regulators chose to keep local rates low at the expense of slower capital recovery and inflated book values.

The slow depreciation policies traditional in telephony are not appropriate in an era of rapid technological innovation and competition — both of which shorten the useful economic lives of telephone assets. Indeed, those policies create artificial disincentives to modernization and efficiency. When the rate of recovery of capital investment is much slower than the rate of consumption of assets, replacement of obsolete equipment is artificially restrained.

The FCC has attempted to remove these artificial disincentives by adopting more accurate depreciation procedures. It determined that the short-term benefits of slow depreciation (*i.e.*, lower rates) were outweighed by the possibly disastrous

long-term costs of outdated telephone company plant and overstated book values. The federal objective to remove disincentives to modernization and efficiency could not be achieved unless the FCC asserted its preemptive authority over inconsistent state depreciation schedules. If application of the more accurate federal procedures were limited to the portion of telephone property assigned to the FCC's jurisdiction (ranging from 10% to 25%), and the States continued to stretch out depreciation periods for the remaining portion, disincentives to modernization would continue. That is because it is impossible to replace only the interstate-assigned portion of an asset. The business decision to replace and modernize equipment necessarily rests on the total amount of unrecovered investment. In short, without the application of accurate depreciation procedures to *both* interstate and intrastate property, the FCC's efforts would be futile.

Preemption of state depreciation policies does not violate Congress' reservation to the States of intrastate ratemaking authority. The legislative history of Section 220 of the Act, which governs depreciation procedures, reveals that Congress specifically rejected an amendment that would have prohibited preemption. Moreover, the States' authority over plant used jointly for intrastate and interstate communications must be interpreted consistently with the Act's broad purpose that a single regulatory authority coordinate nationwide communications services. Finally, although the FCC's preemptive decision removes disincentives to modernization which threaten the interstate (as well as the intrastate) network, the FCC has not interfered with the States' flexibility to mitigate, through judicious use of their ratemaking authority, the effects of short-term increases in depreciation expenses.

ARGUMENT

I. The FCC's Decision Meets This Court's Preemption Test in *de la Cuesta*.

The Communications Act of 1934 establishes a broad federal goal to ensure a "rapid, efficient, Nation-wide" communica-

tions service, and confers expansive powers on the FCC to achieve this goal. 47 U.S.C. § 151 (1982). Although the Act reserves certain areas of authority to the States, the federal agency may exercise preemptive powers "[e]ven where Congress has not completely displaced state regulation in a specific area . . . to the extent that [the state law] actually conflicts with federal law." *Fidelity Federal Savings and Loan Association v. de la Cuesta*, 458 U.S. 141, 153 (1982).

This Court recently restated the test for review of an agency's decision to preempt:

> When the administrator promulgates regulations intended to pre-empt state law, the court's inquiry is . . . limited: "If [h]is choice represents a reasonable accommodation of conflicting policies that were committed to the agency's care by the statute, we should not disturb it unless it appears from the statute or its legislative history that the accommodation is not one that Congress would have sanctioned."

Capital Cities Cable, Inc. v. Crisp, 104 S.Ct. 2694, 2700 (1984), quoting *de la Cuesta*, 458 U.S. at 153-54, and *United States v. Shimer*, 367 U.S. 374, 383 (1961). The Fourth Circuit properly applied this test in reviewing the FCC's decision. *Virginia State Corporation Commission v. FCC*, 737 F.2d 388, 393 (4th Cir. 1984).

Because there is no dispute in this case that the FCC intended to preempt inconsistent state depreciation regulations, review should focus on the following issues:

(1) whether the specific policies at issue "were committed to the agency's care by statute";

(2) whether the agency's decision "represents a reasonable accommodation of conflicting policies"; and

(3) whether that accommodation is "not one that Congress would have sanctioned."

As demonstrated below, the FCC's adoption of more accurate depreciation procedures furthers federal policies favoring plant modernization and efficiency, which were committed to the FCC's care by the Communications Act.[3] Second, in applying the revised depreciation procedures to both interstate and intrastate capital assets, the FCC reasonably balanced the short-term benefits of lower depreciation expenses against the possibly disastrous long-term costs of outdated plant and vastly overstated book values. Third, the preemption of intrastate depreciation schedules does not violate Congress' reservation to the States of intrastate ratemaking authority. Indeed, the legislative history of Section 220 of the Act[4] indicates that Congress specifically left open the alternative of federal preemption by rejecting an amendment that would have forbidden the preemption of state depreciation policies.

II. The Communications Act Committed to the FCC's Care Policies Promoting Modernization and Efficient Use of Technology, Which Are Implemented through Capital Recovery Procedures.

Depreciation procedures determine the rate of recovery of capital investment, and are thus crucial to setting the rate of replacement of facilities which continue to function but have become obsolete. Stretched-out depreciation discourages replacement of outdated facilities, while properly-timed capital recovery allows modernization of the network at an appropriate pace, resulting in a more efficient system at a lower overall cost to society.

The FCC depreciation rules at issue in this case seek to implement goals of modernization and efficiency that were specifically entrusted to the FCC by the Communications Act. 47 U.S.C. §§ 151 and 157 (1982). Section 151 directs the FCC to take steps "to make available . . . a rapid, efficient, Nation--

[3] 47 U.S.C. § 151 (1982) and 47 U.S.C. § 157 (Supp. I 1983). Section 151 of Title 47 was originally Section 1 of the Act. For simplicity's sake, reference to all sections of the Act will use the Title 47 section number.

[4] 47 U.S.C. § 220 (1982).

wide . . . communication service with adequate facilities. . . ." The terms "rapid", "efficient", and "adequate facilities", reflect Congress' desire that communications facilities not be allowed to become outdated and that telephone plant be adequate to keep pace with technological and economic developments.

In order to ensure a reasonable rate of investment so that telephone plant does not become obsolete, Congress empowered the FCC to control the rate of capital investment through the setting of depreciation schedules. Section 220 grants the FCC authority over depreciation requirements, and does not restrict its power to preempt contrary state rules.[5] Depreciation authority is essential to achievement of the broad purpose of Section 151—adequate facilities for rapid and efficient service.

Section 157, enacted in 1983, specifically reaffirms the federal policy of modernization,[6] and recognizes the rapid pace of technological development in the industry:[7]

> It shall be the policy of the United States to encourage the provision of new technologies and services to the public.

[5] *See infra* pp. 23-25.

[6] The House Report describes Congress' intent in enacting Section 157 as follows:

> The Committee has long encouraged the FCC to foster the delivery of new services and new technologies to the public in order to increase competition and promote diversity. Development of new electronic technologies and services has been, and will continue to be, a significant factor in creating jobs and providing U.S. leadership in the new world information era.

H.R. Rep. No. 356, 98th Cong., 1st Sess. 6 (1983).

[7] Although Section 157 was not passed until December 8, 1983, after oral argument before the Fourth Circuit, the amendment simply codified the FCC's policy for over a decade to encourage new technologies and services and to ensure adequate modernization. *E.g., New York State Comm'n on Cable Television v. FCC*, 669 F.2d 58 (2d Cir. 1982); *In re Cox Cable Communications, Inc.*, 50 Fed. Reg. 37, 426 (1985) ("Cox Cable"); *In re Amendment of Parts 2, 21, 87 and 90 of the Commission's Rules*, 86 F.C.C.2d 360 (1981) ("DTS"); The Fourth Circuit apparently did not consider the effect of this amendment in affirming the FCC's preemption order.

47 U.S.C § 157 (Supp. I 1983)

Telecommunications technology has changed rapidly in recent years due to developments such as the widespread use of microwave radio to replace traditional copper telephone wire, the invention and deployment of fiber optic cable, the transition from analog to digital networks, the increased capability of transmission media to send large amounts of data at extremely high speeds, and the implementation of more efficient methods for using the radio spectrum.[8] New technologies or new applications used to transmit voice and data communications include digital termination systems (DTS)[9], coaxial cable[10] and

[8] One area that has shown dramatic technological advances in the past 20 years is switching techniques. Switching technology has progressed from manual to dial to "touch tone," from electromechanical equipment to several generations of electronic switches. The digital switching equipment available today enables companies to offer a greater range of services and produces considerable cost savings. Unfortunately, the rate of electronic conversion has varied among the states, due in part to local regulatory policies. W. Bolter and D. Irwin, *Depreciation Reform: A Crucial Step in Transforming Telecommunications to a Free Market* 41-70 (1980) ("Bolter"); *see generally*, J. Martin, *Future Developments in Telecommunications* (1977).

[9] A Digital Termination System (DTS) is a high-speed digital microwave service designed for users with heavy data traffic. A DTS system consists of a transmitter/receiver station and several customer premise stations. Customers share the same frequency on a time-division basis. A central transmitter sends out a continuous stream of data in all directions, and each user extracts the data specifically addressed to it. DTS can be used to transmit digital data at speeds from 9.6 Kbps up to 1.544 Mbps, and at greater accuracy than traditional analog facilities. It can also be used for digitized voice, facsimile and video conferencing. J. Martin, *Future Developments in Telecommunications* 45-55 (1977). In *In re Amendment of Parts 2, 21, 87 and 90 of the Commission's Rules*, 86 F.C.C.2d 360, 390 (1981), the FCC preempted "inconsistent state regulation of technical standards, market entry standards, and rates and tariff regulations of all carriers using DTS facilities."

[10] Many coaxial cable networks constructed since 1972 for video entertainment have included two-way transmission capabilities to allow for voice and data communications. Coaxial cable has broadband capacity that permits the simultaneous transmission of large volumes of voice, data, facsimile and video communications over a single line. In addition to voice and high-speed data transmission, coaxial cable systems can be used for two-way educational

optical fiber.[11]

Moreover, the simultaneous growth of the computer and electronics industries has allowed businesses and consumers to process and store vast amounts of information. The need to link computer terminals and to transmit large amounts of information conveniently over telephone lines places pressure on telephone companies to provide a range of services in addition to "plain old telephone service."[12] Telephone companies must therefore keep abreast of rapidly advancing technological developments to ensure that their facilities are minimally adequate.[13]

instruction, home banking, data-base access, home shopping services, energy monitoring, and fire and security systems. E. Noam, *Telecommunications Regulation Today and Tomorrow* 362, 383 (1983). In *Cox Cable*, at ¶ 40, the FCC held that "state regulation of institutional services offered by cable companies that acts as a *de facto* or *de jure* barrier to entry into the interstate communications market or to the provision of interstate communications must be preempted."

[11]Fiber optics is a new technology which allows vast amounts of information to be transmitted along thin glass fibers using light as a medium. This contrasts with conventional systems which transmit electrical current along metal cable. In optical fiber systems, photons of light are directed from a light source through a glass fiber to a light detector. The glass fiber is a fine strand of ultrapure glass weighing only one ounce per kilometer; it may be as thin as a human hair. Two-way communications systems utilize pairs of optical fibers, with each fiber carrying light pulses in one direction only. A pair of glass fibers has transmission capability equivalent to thousands of voice/data circuits. Fiber optic trunking systems have already been constructed in many large cities, including New York City and Washington, D.C. Examples include MCI's fiber optic link between Washington, D.C. and New York City and the Teleport system (*see infra* note 14). J. Martin, *Future Developments in Telecommunications* 455-63 (1977).

[12]J. Martin, *Future Developments in Telecommunications* 3-7, 27-42, 313-25 (1977).

[13]For example, while rotary dial telephone service was at one time standard, "Touchtone" service has recently become widely accepted and demanded by many customers. Because special equipment in the telephone company central office is needed to interpret the tones, the existing equipment in some exchanges is unable to transmit tones and must be updated before the service can be offered. J. Martin, *Telecommunications and the Computer* 410 (1976).

Furthermore, the development and deployment of alternatives to traditional copper wire telephone lines have increased the opportunities for competitors to provide communications service at lower cost or with innovative features.[14] Competition has in turn spurred technological development, as demonstrated by the wide range of Customer Premises Equipment ("CPE") (*e.g.*, telephone instruments) offered by competitors since the introduction of competition in the provision of CPE and the removal of CPE from the telephone companies' rate base.[15] The experience with CPE supports the FCC's finding that technological innovation and a competitive market are the best way to ensure an efficient communications network.

Although unable to predict specific technological developments, Congress entrusted the FCC with promoting modernization and efficiency and encouraging the provision of new technologies and services. Congress provided the Commission with sufficient flexibility to achieve this goal through its regulation of depreciation practices. Modernization of telephone com-

[14]An example of a communications system employing newer technology, offered by a vendor other than a local telephone company, is the Teleport system in New York. "The Teleport is a planned satellite communications center/office park complex which will offer wide band communications facilities linked to satellite earth stations [in] Staten Island . . . . In addition to [the] Staten Island facilities, Teleport Communications will offer service over a fiber optic network interconnecting points in New York City and nearby New Jersey with the Teleport site. This fiber optic grid will afford access to the satellite stations as well as a means of communication among user installations at the Teleport and at other locations in the area. It is intended that the Teleport serve as a communications gateway between the New York City metropolitan region and the rest of the nation and world." New York State Public Service Commission Case 28710, *Proceeding as to the Provision of Telephone Services that Bypass Local Exchange or Toll Networks*, Testimony of Rosario P. Romanelli of Teleport Communications (April 30, 1984).

[15]*North Carolina Util. Comm'n v. FCC*, 537 F.2d 787 (4th Cir.), *cert. denied*, 429 U.S. 1027 (1976); *North Carolina Util. Comm'n v. FCC*, 552 F.2d 1036 (4th Cir.), *cert. denied*, 434 U.S. 874 (1977); *Computer and Communications Indus. Ass'n v. FCC*, 693 F.2d 198 (D.C. Cir. 1982), *cert. denied*, 461 U.S. 938 (1983).

pany facilities through investment in new technologies — so that service can be provided more efficiently and new services can be added — falls squarely within the policies committed to the FCC by Congress, the first prong of the *de la Cuesta* test.

III. The FCC's Decision Represents a Reasonable Accommodation between the Need to Prevent Obsolete Telephone Plant and Short-Term Increases in Current Depreciation Expenses.

The FCC has reasonably determined (1) that more accurate depreciation policies are essential to ensure adequate, modernized facilities and to encourage efficiency, and (2) that this federal goal cannot be achieved unless the FCC's depreciation changes are applied to both interstate and intrastate property.

Dramatic technological and economic changes since 1960 forced the FCC to reexamine its traditional depreciation rules, which were designed for a monopoly market with a relatively slow rate of technical innovation. Before the advent of competition in the telephone industry, the dominant carrier (AT&T) could control the pace of innovation because it was insulated from market pressures to adopt new technologies and services. During this period, technical innovation was relatively slow.[16] Regulators could keep rates low by agreeing to stretched-out periods for recovering capital investment, which minimized present expenses and deferred depreciation costs to future years. In effect, depreciation became divorced from the actual use of assets, resulting in depreciation of dollars rather than physical assets. Company books overstated the true value of the company's assets as depreciation expenses failed to reflect adequately the actual consumption of assets. The economic inefficiencies, which developed as book value diverged from true value, were simply not a pressing problem in a monopolistic environment.

[16] *In re Amendment of Part 31, Uniform System of Accounts for Class A and Class B Telephone Companies*, 83 F.C.C.2d 267, 281 (1980); Bolter at B-4.

Because of the way that a rate base-regulated company earns its profits, telephone companies also benefited from deferred depreciation. Through its rates, a regulated utility recovers both operating expenses and allowed earnings on investment, based upon the size of its rate base.[17] When first acquired, a capital asset becomes part of the company's rate base. As it is depreciated, annual depreciation is treated as an operating expense, and the rate base is reduced by a like amount. This in turn reduces allowed earnings on investment, which are calculated by applying a rate of return to the (now diminished) rate base. Depreciation at faster rates therefore increases current operating expenses (for which the company receives only reimbursement) and decreases the rate base (which is the basis for calculating the company's allowable earnings).[18] When depreciation is deferred, the telephone company earns the allowed rate of return on underdepreciated (*i.e.*, overvalued) capital assets.[19]

As long as telephone companies could be shielded from competitive pressures to adopt technological innovations, stretched-out depreciation schedules served the short-term interests of regulators, telephone company shareholders, and ratepayers. Regulation, rather than technology, effectively controlled — and slowed — the introduction of new plant and equipment. Rapid technological development, which opened the door to competition, curtailed regulators' ability to main-

[17] Rate base rate-of-return regulation traditionally applied to telephone companies requires rates to be set at levels that generate revenues sufficient to cover (1) annual operating expenses — including an annual depreciation charge to recover the company's investment in assets as they are used — and (2) a return on investment. The return on investment is calculated as a percentage of the rate base (which does not include operating expenses). *See generally* 1 A. Kahn, *The Economics of Regulation* (1970).

[18] Of course, if a company were to obtain new capital assets to replace depreciated assets, then investments in new technology could produce a net increase in the total rate base.

[19] *See* NTIA Special Publication 85-16, *Issues in Domestic Telecommunications: Directives for National Policy* 137 (July 1985).

tain these policies, as the increasing availability of lower cost production technologies and customer demand for innovative services placed practical limits upon the economic life and value of older equipment.

The Commission recognized that continued adherence to traditional slow depreciation policies would lead to a growing divergence between the book value of telephone plant and its true economic value. *In re Amendment of Part 31, Uniform System of Accounts for Class A and Class B Telephone Companies*, 83 F.C.C.2d 267 (1980). The company's shareholders would then run the risk of not receiving adequate compensation through depreciation reserves for the loss in economic value, and the cost of capital for these companies would increase as investors perceived the companies as poor risks.[20] 83 F.C.C.2d at 272. Modernization efforts would be hindered, resulting in less efficient plant.[21] Something eventually would have to be

[20]When an asset is taken out of service before it has been fully depreciated, it receives the same accounting treatment as if it had been fully depreciated. The net rate base is *not* decreased to reflect the asset's retirement, even though insufficient depreciation was taken. 47 C.F.R. § 31.2-25 (1984). This leads to an overstatement of net investment (*i.e.*, actual book value). The resulting difference between book value and actual economic value has been termed "phantom costs." Bolter at 98-99. Ratepayers in future years are forced to pay this depreciation shortfall. As the depreciation deficiencies grow, telephone company managers are reluctant to assume more "phantom costs," which will cause further divergence of book value from economic value. The possibility that regulators may force the company to write off the "phantom costs" and the pressure from competitive alternatives (based on actual costs) place the company's recovery of "phantom costs" at risk. As the market perceives the increased level of risk, the company's cost of capital increases, adversely affecting its ability to obtain funds for construction of newer facilities.

[21]In addition, those customers with heavy usage who can afford to obtain services which use more up-to-date technology and are tailored to their specifications may turn to suppliers other than the telephone company. Smaller users who do not have enough communications usage to justify their own systems are left to cover much of a largely fixed revenue requirement, with a resulting increase in rates for all remaining customers. *See National Ass'n of Regulatory Util. Comm'rs v. FCC*, 737 F.2d 1095, 1116-17 (D.C. Cir. 1984), *cert. denied*, 105 S.Ct 1224 (1985).

done to avoid obsolescence of the telephone network and the need to upgrade it at great cost to ratepayers, shareholders, or both. 1 A. Kahn, *The Economics of Regulation* 117-22 (1970).[22]

The FCC sought to address the "modernization problem" through three changes in depreciation procedures. First, the FCC replaced the traditional depreciation procedure, the vintage group method, with the more accurate equal life group method. 83 F.C.C.2d 267 (1980). Under vintage grouping, all types of equipment installed during one year are grouped together (regardless of their varying life expectancies) and depreciated over the average life of the group.[23] Under equal life grouping, equipment is divided into smaller subgroups so that all items in a subgroup have the same approximate life expectancy.[24] Each subgroup is then assigned its own depreciation schedule, resulting in capital recovery more closely tied to actual useful life.

The FCC explained that "technological trends suggest an increasingly dynamic environment for telecommunications. . . . [I]f the public is to realize the benefits of [technological] advances . . . it is necessary that accounting and depreciation rules not stifle innovation and inhibit the introduction of new technology." *Id.* at 281. The FCC directly addressed the tension between maintaining an efficient, modern

[22]The FCC carefully considered whether the company's shareholders or its ratepayers should bear the risks of the technological changes which caused inadequate depreciation reserves. It concluded that, as a matter of established regulatory law, ratepayers were responsible for such deficiencies. *Democratic Cent. Comm. v. Washington Metropolitan Area Transit Comm'n*, 485 F.2d 786 (D.C. Cir. 1973), *discussed in* 83 F.C.C.2d at 275-77, *cert. denied sub nom. D.C. Transit Sys., Inc. v. Democratic Cent. Comm.*, 415 U.S. 935 (1974).

[23]Because depreciating each item of equipment individually is impractical, telephone equipment is placed in groups for depreciation purposes.

[24]For example, under vintage grouping, all telephone cable installed in one year is depreciated at the same rate. Under equal life grouping, indoor cable would be depreciated at a different rate from underground cable because of their different life expectancies.

network and keeping depreciation expenses low in the short-term:

> The seeming attraction of stretching out lives to hold down depreciation expenses may impose longer-term costs on our society that far out weigh the short-term advantages. Although [Equal Life Grouping] is likely to result in an increase in the near term in revenue requirements, we believe that the relative size of the increment will be repaid many times over in future years as the ability of regulated telephone companies to continue to provide ". . . rapid, efficient . . . communication service with adequate facilities at reasonable charges is enhanced."

Id. at 281.

Second, the Commission adopted the remaining life method for correcting errors in the forecasts of the useful life of assets in place of the whole life method. The whole life method requires calculation of annual depreciation as if the whole life of an asset was correctly estimated from the start, even if it becomes clear at a later time that the initial estimate was wrong. The remaining life method allows the carrier to correct useful life estimates by allocating any unrecovered depreciation over the more accurate remaining life.[25]

Again, the FCC cited "the impact of new technology and the transition from a monopoly to a competitive environment [which] have led to an overall shortening of life estimates," not anticipated when depreciation rates were originally set. Without future corrective action, the depreciation deficiencies

[25]For example, the original estimated useful life of an asset may be 10 years with 10% depreciation taken each year. By the end of the second year, 20% of the capital investment would have been depreciated. Technological developments may then make it clear that the useful life of the asset is five rather than ten years. Under the whole life method, the annual depreciation would be revised to 20% for the third, fourth and fifth years, for a total depreciation for this asset of 80%. Under the remaining life method, depreciation for the third, fourth and fifth years would be approximately 26.7% so that 100% of the costs of the asset would be recovered at the end of five years.

would continue to grow. *Id.* at 290. A corrective mechanism would help the companies "to measure as accurately as possible the consumption of capital in a capital intensive enterprise." *Id.* at 288.[26]

Third, the FCC ordered that inside wiring, which had been capitalized and depreciated, be treated instead as a current expense. *In re Amendment of Part 31, Uniform System of Accounts for Class A and Class B Telephone Companies*, 85 F.C.C.2d 818, 827 (1981).[27] This change gave effect to FCC policies that capital recovery should be tied to the actual use of assets and that cost burdens should not be borne by future ratepayers who do not benefit from the expenditure. Because the costs of inside wiring are "dictated and governed by the [customer's] selection and placement of terminal equipment," and the "service life and location costs are generated and controlled by individual customers' decisions," the costs should be borne by the current ratepayers who use the inside wiring, rather than future ratepayers. *Id.* at 827.[28]

[26]The FCC allowed telephone companies the option of adopting the equal life group or the remaining life approaches, assuming that the companies could best determine the state of their equipment and the need for modernization. *In re Amendment of Part 31*, 83 F.C.C.2d at 293.

[27]Inside wiring is the cost of installing wiring for telephone or telecommunications services inside the premises of a business or residence. Recently, companies offering CPE have begun to install the wiring themselves in connection with their provision of CPE. *Id.*

[28]The FCC recognized that the optimal solution was to detariff inside wiring and thus place the costs on the immediate customer who actually ordered, and thus caused, the expenditure. With the growth of competition in the provision of station connections, including the provision of inside wire, the FCC was forced to reconsider whether inside wiring costs should continue to be charged to the general body of ratepayers through capitalization and depreciation. Customers who obtained station connections from sources other than the telephone company would otherwise have to pay telephone rates that included depreciation and a return on investment attributable to the telephone company's provision of station connections for other customers. *Id.* at 827; *Computer and Communications Indus. Ass'n v. FCC*, 693 F.2d 198 (D.C. Cir. 1982), *cert denied*, 461 U.S. 938 (1983). The FCC concluded that it would defer taking the step of ordering detariffing, and begin by

The equal life grouping method, the remaining life method, and the expensing of inside wiring were reasonable approaches by the FCC to the problems of growing depreciation reserve deficiencies and disincentives to modernize. The new depreciation procedures reflect more accurately the actual use of assets, allow mid-course corrections to erroneous life estimates, and remove some of the burden of current costs from future ratepayers.[29]

Once it is accepted that the FCC acted reasonably in adopting depreciation procedures that implement the statutorily-established policies of modernization and efficiency, there is little question that preemption of inconsistent state regulations is appropriate, indeed essential. Because telephone plant is used interchangeably for interstate and intrastate communications, procedures outlined in the Separations Manual must be used to allocate the costs of the plant between the jurisdictions.[30] Currently, approximately 25% of non-usage-sensitive

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placing the burden on "all customers at the time the expenditures were made (as opposed to present and future customers when the costs are capitalized). . . . Thus, while our ultimate goal is to see that this burden is placed on the cost causative customer, the continued strict adherence to full capitalization will continue to permit this problem to grow. This is a situation which we believe is unacceptable." 85 F.C.C. 2d at 828.

[29]Predicting the useful life of any asset is inherently imprecise and relies heavily upon the agency's engineering, technical and economic expertise and its reasoned judgment. Fixing depreciation rates requires the agency to forecast the useful lives of different types of assets, which in turn depends upon predictions of technological developments in the industry. The FCC must also consider social policy issues, including the effect of increased depreciation expenses on intrastate revenue requirements and the agency's statutory duty to ensure an efficient network and to encourage new technology. The agency's decision to change depreciation procedures and adopt corrective measures should therefore be accorded considerable deference. *Smith v. Illinois Bell Tel. Co.*, 282 U.S. 133 (1930). No party sought judicial review of either of the FCC's orders on depreciation underlying the preemption decision.

[30]*Smith v. Illinois Bell Tel. Co.*, 282 U.S. 133, 149 (1930), held that a state commission could not set rates based on total telephone company plant, without some apportionment of costs between the intrastate and interstate

plant and roughly 10% of usage-sensitive plant are allocated to the interstate jurisdiction. If the FCC were to impose its depreciation changes on at most 25% of the separated plant costs, and the States continued to follow slower depreciation schedules to keep current rates low, the FCC's actions would have little impact on capital investment decisions.

A businessman deciding to retire older assets used for both interstate and intrastate service does not distinguish between interstate and intrastate depreciation. It is impossible to replace the "interstate portion" of the asset, which may have been fully depreciated, without also replacing the "intrastate portion" of the asset, which may not have been fully depreciated. The decision to replace equipment that serves both jurisdictions inevitably turns on the *total* amount of unrecovered investment, taking into account both intrastate and interstate depreciation schedules. The effect of intrastate depreciation policies is thus truly "inseparable" from the effect of interstate depreciation policies in influencing the economic decision to retire and replace obsolete equipment.

This "inseparability" brings the present case squarely within a line of court of appeals decisions authorizing FCC preemption based upon "inseparability." In *North Carolina Utilities Commission v. FCC*, 537 F.2d 787 (4th Cir.), *cert. denied*, 429 U.S. 1027 (1976), the Fourth Circuit upheld the FCC's preemption of

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jurisdictions. Although *Smith* did not mandate apportionment based on usage, the system of allocation that has grown out of *Smith* divides plant costs by comparing interstate and intrastate usage. *National Ass'n of Regulatory Util. Comm'rs v. FCC*, 737 F.2d 1095, 1113 (D.C. Cir. 1984), *cert. denied*, 105 S.Ct 1224 (1985). The elaborate procedures for jurisdictional allocations of costs are contained in the so-called Separations Manual, and the regulations implementing it. 47 C.F.R. Part 67 (1984). In 1971, Congress amended the Communications Act to add Section 410, establishing a Joint Board composed of state and federal representatives, to provide recommendations to the FCC regarding, *inter alia*, "jurisdictional separation of common carrier property and expenses between interstate and intrastate operations." 47 U.S.C. § 410(c) (1982). Changes to the Separations Manual are reviewed by the Joint Board, and the FCC may then adopt or reject the Joint Board's recommendations.

state regulations prohibiting the interconnection of customer premises equipment used to place both interstate and intrastate calls. The court agreed with the FCC that "[u]sually, it is not *feasible as a matter of economics* and *practicality of operation*, to limit the use of such equipment to either interstate or intrastate transmissions." 537 F.2d at 791 (emphasis added). It concluded that the intrastate jurisdiction under 47 U.S.C. § 152(b) (1982)[31] extended only to those facilities "separable from and . . . not substantially affect[ing] the conduct or development of interstate communications." The "inseparability" factor has been cited in a number of other cases upholding the FCC's preemptive authority. *E.g.*, *National Association of Regulatory Utility Commissioners v. FCC*, 746 F.2d 1492 (D.C. Cir. 1984); *California v. FCC*, 567 F.2d 84 (D.C. Cir. 1977), *cert. denied*, 434 U.S. 1010 (1978); *Puerto Rico Telephone Co. v. FCC*, 553 F.2d 694, 700 (1st Cir. 1977); *North Carolina Utilities Commission v. FCC*, 552 F.2d 1036 (4th Cir), *cert. denied*, 434 U.S. 874 (1977).

"Inseparability," although important, is only one of several factors to be considered in deciding whether state law "stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress," *Hines v. Davidowitz*, 312 U.S. 52, 67 (1941). State depreciation policies, in addition to blocking federal objectives, may place unfair burdens upon interstate ratepayers due to the operation of the Separations process. The FCC noted that "[T]he utilization of one depreciation rate is the most effective method for insuring that . . . no jurisdiction bears a greater burden than another . . . . [S]ignificant inequities would [otherwise] result to both ratepayers and carriers."[32] *In re Amendment of Part 31, Uniform System of Accounts for Class A and Class B Telephone Companies*, 92 F.C.C.2d 864 (1983).

[31]*See infra* pp. 25-27.

[32]For example, assume an initial investment of $100,000 in non-usage-sensitive plant. Separations initially assigns approximately $25,000 of the $100,000 asset to the interstate jurisdiction and $75,000 to the intrastate jurisdiction. Federal depreciation procedures adopt a more accurate five-year life while state procedures retain a ten-year life. After the first year of depreciation, the remaining interstate costs will be $20,000, and the remaining intrastate costs will be $67,500, for a total of $87,500. In the second year, the total costs of $87,500 are separated to allocate 25% (or $21,875) to the interstate jurisdiction and 75% (or $65,625) to the intrastate jurisdiction. Had the state followed the federal five-year life, only $20,000 would have been allocated to the interstate jurisdiction. Thus, unless a state adopts federal procedures, interstate customers are effectively penalized by paying more than their share of separated costs over time—simply because the FCC has used more accurate depreciation procedures.

The FCC has recognized that state regulations "would obstruct the accomplishment and execution of the full purposes of Congress." *Id.* at 868. The provision for adequate capital recovery is important to achieve the purpose of Congress for the provision of a "rapid, efficient, Nation-wide" service. *Id.* at 876. "State depreciation rate prescriptions . . . do not adequately provide for capital recovery in the competitive environment, [and] in an increasingly competitive environment, it is possible that *improper capital recovery could delay or prevent modernization which would add to the costs borne by ratepayers* and could, ultimately, threaten carriers' ability to fully recover their invested capital." *Id.* at 877 (emphasis added). The Commission considered the possible effect on increased intrastate revenue requirements[33] but reached a reasonable accommodation in deciding that the advancement of federal goals requires preemption to preclude the higher long-term costs (both interstate and intrastate) of outdated networks and financially weakened telephone companies.

In sum, the valid federal objectives of modernization and efficiency *simply cannot be achieved* without preempting state

[33]State interests to be considered are the state's general interest in protecting its ratemaking authority under Section 152(b) and its specific interest in keeping intrastate depreciation expenses and revenue requirements low in the short-term. The FCC weighed the short-term benefits of lower depreciation expenses against the long-term costs of inefficient and obsolete plant, and concluded that more accurate depreciation procedures were essential, even if expenses would increase in the short-term. *See supra* p. 15. The States' ratemaking authority under Section 152(b) is discussed *infra* pp. 25-29.

regulations which create substantial disincentives to the replacement of obsolete but underdepreciated assets. In order to ensure a rapid, efficient network with adequate facilities, the FCC properly overrode the States' short-term interest in avoiding increased depreciation expenses, thus meeting the second prong of the *de la Cuesta* test.[34]

IV. The FCC's Preemption of State Depreciation Rules Does Not Fall within Section 152(b)'s Reservation of State Authority.

The final prong of the *de la Cuesta* test states:

> [W]e should not disturb [a preemption decision] *unless* it appears from the statute or the legislative history that *the accommodation is not one that Congress would have sanctioned.*

458 U.S. at 154 (emphasis added). Stated differently, assuming the other elements of the test are met, this Court will uphold an agency's preemption decision in the absence of a showing that Congress would have disapproved of such a result.

Section 2(b) of the Act, 47 U.S.C. § 152(b) (1982), does not indicate that Congress would have disapproved of federal preemption of state depreciation procedures. The imposition of federal depreciation rules does not fall within the prohibition of that Section:

> [S]ubject to the provisions of section 301 of this title . . . nothing in this chapter shall be construed to apply or to give the Commission jurisdiction with respect to . . . charges, classifications, practices, services, facilities, or

[34]The Fourth Circuit reviewed the FCC's actions under the *de la Cuesta* test and concluded that the FCC had acted "within its authority to ensure efficient operation of the interstate network." Recognizing that usually at least 75% of investment in new plant is intrastate, the court explained that "[i]f that large amount of equipment investment should fail properly to reflect its true, rapid depreciation, *interstate service would then suffer the effects of delayed innovation.*" *Virginia State Corp. Comm'n v. FCC*, 737 F.2d 388, 395 (emphasis added).

> regulations for or in connection with intrastate communication service by wire or radio of any carrier. . . .

Although Section 152(b) indicates that Congress did not intend to displace *all* state communications regulation, it is necessary to examine other provisions of the Act and its legislative history to determine (1) whether Congress intended to include depreciation procedures within the area reserved to the States; and (2) whether Section 152(b) should be read narrowly or broadly in the event of a jurisdictional conflict.

In fact, Congress specifically rejected an amendment, urged by the States, which would have precluded federal preemption of state depreciation rules by reserving to the States the authority to prescribe depreciation rates. And Sections 151 and 153, which establish the FCC's sweeping mandate and broadly define the interstate jurisdiction, support a narrow reading of the States' authority under Section 152(b).

A. Congress Specifically Rejected an Amendment to Section 220 That Would Have Prohibited Preemption.

Section 220 of the Act reflects Congress' intent to establish a uniform depreciation system for the capital recovery of assets used jointly in both jurisdictions. Section 220(b) provides that the FCC "shall" prescribe depreciation charges for carriers under the Act and prohibits carriers from depreciating any property, or using any rate of depreciation, other than that adopted by the FCC.[35] Subsections (b) through (g) of Section 220 are identical to the depreciation provisions in the Interstate Commerce Act, which by 1934 had been interpreted to give the Interstate Commerce Commission authority to preempt state depreciation charges.[36]

[35]In contrast, Section 220(a) states that "[t]he Commission may, in its discretion, prescribe the forms of any and all accounts." 47 U.S.C. § 220(a) (1982). Congress thus clearly distinguished between the FCC's discretionary authority to set up a uniform accounting system and its mandatory duty to establish uniform depreciation procedures.

[36]*Depreciation Charges of Telephone Companies and Depreciation Charges of Steam Railroad Companies*, decided together at 118 I.C.C. 295, 328-33 (1926), *further proceedings*, 177 I.C.C. 351 (1931).

During the hearings on what became the Communications Act of 1934, the States objected that modeling the FCC's depreciation section after the Interstate Commerce Act would allow the FCC to preempt State depreciation schedules and proposed an amendment which would have removed intrastate depreciation from the FCC's authority.[37] The amendment would have reserved to the States authority "to prescribe, for purposes of the exercise of its jurisdiction with respect to any carrier, the percentage rate of depreciation."[38] The Senate refused to adopt the States' amendment, however, and the Interstate Commerce Act version of the section was ultimately adopted, confirming the agency's preemptive power over depreciation.[39]

Congress took the States' concerns into account by requiring the FCC to give notice to the States before prescribing any requirements and to afford each state commission an opportunity to present its "views and recommendations." Congress also allowed the FCC to except certain carriers from Section 220's requirements — "consistent with the public interest" — "where such carriers are subject to state commission regulation." 47 U.S.C. § 220(h) (1982). Congress contemplated that the Commission would first prepare a report on federal-state relations before any further legislative action was taken to strengthen the States' authority. 47 U.S.C. § 220(j) (1982).

Congress may in fact have intended in Section 220 to remove *all* state authority to set depreciation rules. *Amendment of Part 31, Uniform System of Accounts for Class A and Class B Telephone Companies*, 92 F.C.C.2d 864, 867 (1983). But the *de la Cuesta* preemption test does not require such a showing. This Court need only consider that, after full consideration of the issue by both Houses, the 1934 Congress refused to adopt

[37] *Hearings on S. 2910 Before the Senate Committee on Interstate Commerce*, 73d Cong., 2d Sess. 181 (1934) (statement on behalf of NARUC).

[38] *See* S. 3285, 73d Cong., 2d Sess. § 220(j), (June 1, 1934) (House Committee Version), *reported in* H.R. Rep. No. 1850, 73d Cong., 2d Sess. 7 (1934).

[39] *See* S. Rep. No. 781, 73d Cong., 2d Sess. 5 (1934); H.R. Rep. No. 1918, 73d Cong., 2d Sess. 47 (1934).

an amendment that would have prohibited the very action challenged by the States today. Instead, Congress enacted a series of provisions that make the FCC's authority in this area clear and demonstrate, at the very least, that Congress did not wish to prevent FCC preemption. The final prong of the *de la Cuesta* test is thus met.

B. Since Most Telephone Plant Is Used for Both Interstate and Intrastate Communications, Section 152(b) Must Be Read Narrowly in Order to Achieve the Purposes of the Act.

The FCC's depreciation decision does not intrude upon Section 152(b)'s reservation of state jurisdiction, which must be read in a manner that makes it consistent with other provisions of the Act. Section 151 confers extensive powers on the FCC "to make available, so far as possible, to all the people of the United States a rapid, efficient, Nation-wide, and world-wide radio and communication service with adequate facilities at reasonable charges." 47 U.S.C. § 151 (1982). Section 153, which grants the FCC's jurisdiction over "interstate communications" or "interstate transmission," defines those terms broadly to include any "communications or transmission . . . from any State . . . to any other State," including all facilities and service "incidental to such transmission." 47 U.S.C. § 153 (1982).

Because telephone plant has always been used jointly for both interstate and intrastate communications,[40] an expansive

[40] A telephone call — whether interstate or intrastate — originates in the same telephone instrument (CPE) and traverses the same inside wiring and telephone lines to reach the first point of switching, the local telephone company's central office. Prior to the AT&T divestiture, facilities were not configured to handle interstate toll calls differently than intrastate toll calls and this has not changed. Since divestiture, a distinction has been drawn between interLATA and intraLATA calls. A LATA (Local Access and Transport Area) is one of over 150 geographical regions, all larger than a single local exchange, whose boundaries were drawn during the MFJ Consent Decree negotiation process. The Bell Operating Companies ("BOCs") may operate only within a LATA, and thus they carry only local and *intra*LATA

reading of Section 152(b) would contradict the sweeping purposes of the Communications Act. Were Section 152(b) read to allow the Commission "to exercise its jurisdiction only where the telephone facilities in question were exclusively interstate in character, it would result in virtually complete abdication from the field of telephone regulation." *North Carolina Utilities Commission v. FCC*, 537 F.2d at 794, quoting *Katz v. American Telephone and Telegraph Co.*, 43 F.C.C. 1328, 1332 (1943).

The FCC and the lower courts have repeatedly rejected interpretations of Section 152(b) that would deprive the Commission of authority over facilities and equipment used in connection with both interstate and intrastate communications. Section 152(b) should not be interpreted to obstruct "the broad purposes of the Act" and the "comprehensive and pervasive" responsibilities of FCC. "Any other determination would tend to fragment the regulation of a communications activity which cannot be regulated on any realistic basis except by a central authority; fifty states and myriad local authorities cannot effectively deal with bits and pieces of what is really a unified system of communication." *General Telephone Company v. FCC*, 413 F.2d 390, 401 (D.C. Cir.), *cert. denied*, 396 U.S. 888 (1969). Consistent with the goal of a unified system of communication subject to a central authority, lower courts have upheld the FCC's assertion of jurisdiction in such diverse areas as state certification requirements for CPE, (*North Carolina Utilities Commission v. FCC*, 552 F.2d 1036 (4th Cir. 1977); *North Carolina Utilities Commission v. FCC*, 537 F.2d 787 (4th Cir. 1976)); the detariffing of CPE (*Computer and Communication Industry Association v. FCC*, 693 F.2d 198 (D.C. Cir. 1982)); intrastate private lines which are part of interstate networks (*National Association of Regulatory Utility Commissioners v. FCC*, 737 F.2d 1095 (D.C. Cir. 1984); *California v. FCC*, 567 F.2d 84 (D.C. Cir. 1977), *cert. denied*, 434 U.S. 1010 (1978)); and state regulation of particular developing technologies (*New York State Commission on Cable Television v. FCC*, 669 F.2d 58 (2d Cir. 1982)). Industry expectations have evolved, and business decisions have been made, in a way that recognizes the coordinated, unified nature of the nation's communications network and the paramount importance of unfettered interstate communications.

toll calls. Interexchange carriers, such as AT&T Communications and MCI, carry interLATA (and interstate) toll calls. (Some states allow interexchange carriers to carry intraLATA calls as well.) InterLATA calls may be either interstate or intrastate, and intraLATA calls, although primarily intrastate, may also be interstate. Although the BOCs are taking steps to reconfigure their networks to conform to LATA boundaries, they continue to draw no distinction in the use of facilities to handle the local access portions of interstate and intrastate toll calls. *See supra* note 1.

Moreover, Congress has not been unaware of the FCC's and the courts' interpretation of Section 152(b). In 1971, it amended the Act by adding the present Section 410(c), dealing with matters of federal-state concern. 47 U.S.C. § 410(c) (1982). That section confers upon the FCC discretionary power to refer any matter "relating to common carrier communications of joint Federal-State concern, to a Federal-State Joint Board." The FCC is required to refer to the Joint Board "any proceeding regarding jurisdictional separation of common carrier property and expenses between interstate and intrastate operations." Joint Board recommendations have no binding effect, however; the Commission alone is authorized to make final decisions. Had Congress believed that the FCC's expansive exercise of federal jurisdiction impinged upon an area reserved to the States, it would have redressed the perceived imbalance, not created a Joint Board empowered only to advise the FCC. *See North Carolina Utilities Commission v. FCC*, 537 F.2d 787, 795.

In 1983, Congress affirmed the FCC's specific policy of encouraging new technologies and services by adding Section 157 to the Act and implicitly approving the FCC's prior preemption of state regulation of developing technologies such as DTS. *In re Amendment of Parts 2, 21, 87 and 90 of the Commission's Rules*, 86 F.C.C.2d 360 (1981).

C. The States Retain Flexibility to Mitigate the Effects of Short-Term Increases in Depreciation Expenses.

While the FCC's preemption decision ensures that more accurately-timed depreciation removes disincentives to modernization, the States retain considerable flexibility in implementing the depreciation changes. The revised depreciation procedures will inevitably result in increased intrastate depreciation expenses, but this phenomenon will last only until the serious problem of depreciation deficiencies is resolved. The FCC decision changes only the timing of capital recovery; it does not increase the total costs to be recovered.

Furthermore, depreciation expenses constitute only one of hundreds of costs that go into the setting of intrastate revenue requirements. Just as the States have the flexibility to make adjustments for increases in equipment manufacturers' costs, they have a range of responses to increased costs from depreciation changes. The States, for example, may adjust rates of return to recognize the decrease in the degree of risk due to corrective measures that bring book value in line with economic value. Even when intrastate revenue requirements increase, the States retain authority to allocate the intrastate portion of these short-term increases among intrastate services. It is possible for the FCC to achieve its goal of removing disincentives to modernization while at the same time leaving the States with substantial ratemaking authority to cushion the impact of increases in depreciation expenses on local rates.

As the Fourth Circuit Court of Appeals noted in addressing a state argument that preemption of CPE would "jeopardize state ratemaking prerogatives to subsidize" local service:

> Political expediency may encourage state commissions to defend their current option to bury subsidy costs in as many holes as possible, but this concern cannot be allowed to determine the allocation of jurisdictional competency between state and federal agencies.

North Carolina Utilities Commission v. FCC, 552 F.2d 1036, 1048. Removal of one option does not curtail the States' flexibility to make adjustments in other areas to ensure continued low rates for local service. The States have many choices, and need not pass all of the increase in depreciation expenses directly to local service customers.

If federal actions were constrained simply because they remove one of many available options from the States' grasp, the FCC would be essentially powerless to ensure a rapid, efficient, nationwide network. If Section 152(b) were to prohibit any federal action that affects a source of subsidy for local service or that increases intrastate revenue requirements, interstate regulation would become a nullity. That would clearly defeat Congress' goal of a unified and efficient nationwide communications network with adequate facilities.

CONCLUSION

This Court should affirm the Fourth Circuit's decision upholding the FCC's preemption of state depreciation procedures which frustrate the federal objectives of modernization and efficiency. Review is limited to the elements prescribed in this Court's preemption test in *de la Cuesta*, and, as demonstrated above, each of these elements has been met.

Respectfully submitted,

LAURENCE H. SILBERMAN*
HENRY D. LEVINE
JOY LEONG KUNSBERG
MORRISON & FOERSTER
2000 Pennsylvania Avenue, N.W.
Washington, D.C. 20006
(202) 887-1500

**Counsel of Record*

Attorneys for MCI Telecommunications Corporation

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IN THE

Supreme Court of the United States

October Term, 1985

Louisiana Public Service Commission

Appellant

v.

Federal Communications Commission and United States of America

Appellees

California and Public Utilities Commission of California, et al.

Petitioners

v.

Federal Communications Commission and United States of America

Respondents

Public Utilities Commission of Ohio, et al.

Petitioners

v.

Federal Communications Commission and United States of America

Respondents

Florida Public Service Commission

Petitioner

v.

Federal Communications Commission and United States of America

Respondents

On Appeal And On Petitions For A Writ of Certiorari To The United States Court of Appeals For The Fourth Circuit

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BRIEF OF THE UNITED STATES TELEPHONE ASSOCIATION, AS *AMICUS CURIAE*, IN SUPPORT OF THE APPELLEES AND RESPONDENTS

Joseph R. Fogarty
H. Russell Frisby, Jr.
Marcia Spielholz

Weil, Gotshal & Manges
1101 Fourteenth Street, N.W.
Washington, D.C. 20005
(202) 682-7000

Jack E. Herington
General Counsel
United States Telephone Association
1801 K Street, N.W.
Washington, D.C. 20006
(202) 872-1200

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IN THE

Supreme Court of the United States

October Term, 1985

Louisiana Public Service Commission

Appellant

v.

Federal Communications Commission and United States of America

Appellees

California and Public Utilities Commission of California, et al.

Petitioners

v.

Federal Communications Commission and United States of America

Respondents

Public Utilities Commission of Ohio, et al.

Petitioners

v.

Federal Communications Commission and United States of America

Respondents

Florida Public Service Commission

Petitioner

v.

Federal Communications Commission and United States of America

Respondents

On Appeal And On Petitions For A Writ of Certiorari To The United States Court of Appeals For The Fourth Circuit

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BRIEF OF THE UNITED STATES TELEPHONE ASSOCIATION, AS *AMICUS CURIAE*, IN SUPPORT OF THE APPELLEES AND RESPONDENTS

The United States Telephone Association ("USTA") submits this brief as amicus curiae, pursuant to Rule 36 of the Rules of this Court in support of appellees and respondents Federal Communications Commission ("FCC" or "Commission"), *et al.*, urging affirmance of the judgment of the United States Court of Appeals for the Fourth Circuit in *Virginia State Corp. Commission* v. *FCC*, 737 F.2d 388 (4th Cir. 1984), *Motions for Hearing En Banc Denied*, Oct. 3, 1984 ("VSCC"). In this decision, the Court of Appeals affirmed an order of the FCC preempting inconsistent state regulation of depreciation rates and classes of property. *Amendment of Part 31, Uniform System of Accounts and Petition for Declaratory Ruling on Questions of Federal Preemption*, 92 F.C.C.2d 864 (1983) ("1983 Preemption Order"), *on reconsideration of* 89 F.C.C.2d 1094 (1982) ("1982 Preemption Order"). USTA seeks to demonstrate below why the Fourth Circuit's judgment should be affirmed.[1]

INTEREST OF THE *AMICUS CURIAE*

The United States Telephone Association is the national trade association of the telephone exchange carrier industry. Its members include telephone companies in every state and serve over 99% of this nation's telephone access lines.

The FCC regulations at issue in this proceeding vitally affect the interests of USTA's members. The adequate and timely capital recovery fostered by federal preemption of inconsistent state regulation of depreciation rates and methods is essential to the financial well-being of the USTA membership. While some of USTA's larger members are parties to this proceeding, the majority are not. Thus, the views of many telephone companies would not be heard but for USTA's participation as an amicus curiae. The purpose of this brief is to provide the Court with an awareness of the economic facts which underlie

[1]This brief is submitted upon the written consent of all parties, copies of which are filed herewith.

and justify the FCC's decision to preempt inconsistent state depreciation regulation.

SUMMARY OF THE ARGUMENT

The question before this Court is whether the Court of Appeals correctly held that the FCC acted within the scope of its authority in determining that its prescription of certain depreciation practices for telephone equipment preempted state commissions from prescribing inconsistent depreciation practices. The Court of Appeals' decision is correct. Congress, the courts, and the FCC have established a national policy in favor of encouraging the provision of modern, efficient nationwide communication service at reasonable rates and the provision of new technologies and services to the public. This policy displaces all inconsistent state regulation. The assurance of adequate capital recovery for telephone companies is critical to the accomplishment of this federal policy. The FCC properly found that inconsistent state regulation would frustrate that policy. Based upon principles reinforced in the Court's recent unanimous decision in *Capital Cities Cable, Inc.* v. *Crisp*, 104 S. Ct. 2694 (1984), the FCC's *1983 Preemption Order* is valid and should be affirmed.

ARGUMENT

I. ADEQUATE AND TIMELY CAPITAL RECOVERY IS ESSENTIAL TO THE IMPLEMENTATION OF NATIONAL POLICY

During the last forty years, a near-revolutionary change has occurred in the telephone industry as a result of tremendous technological developments. *See, Third Computer Inquiry*, FCC 85-397, slip op. at 2, 14 (Aug. 16, 1985). Spurred by these technological developments, and recognizing that the promotion of competition is a legitimate means of meeting the FCC's mandate under Section 1 of the Communications Act of 1934 "to make available,... a rapid, efficient, Nation- wide,... wire and radio communication service with adequate facilities at reasonable charges...", 47 U.S.C. § 151, both the FCC and the courts have rendered numerous decisions encouraging the develop-

ment of competition[2] as a means of achieving important public benefits such as enhanced technological innovation, lower consumer rates, and an increase in the diversity, quality, and efficiency of telecommunications equipment and service offerings. *See, e.g.*, *United States* v. *AT&T*, 552 F. Supp. 131 (D.D.C. 1982), *aff'd sub nom. Maryland* v. *United States* 460 U.S. 1001 (1983). As a result, a technologically advanced competitive environment pervades the telecommunications marketplace in the United States.

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[2]The FCC and the courts have rendered numerous decisions promoting competition in the provision of telephone terminal and accessory equipment, long distance telecommunications, and "enhanced" computer/telecommunications services in order to encourage the emergence of numerous new telecommmunications services and providers. *See, e.g.*, *MCI Telecommunications Corp.* v. *FCC*, 561 F.2d 365 (D.C. Cir. 1977), *cert. denied*, 434 U.S. 1040 (1978), and *MCI Telecommunications Corp.* v. *FCC*, 580 F.2d 590 (D.C. Cir. 1978), *cert. denied*, 439 U.S. 980 (1978); *Microwave Communications, Inc.*, 18 F.C.C.2d 953 (1969), *on reconsideration*, 21 F.C.C.2d 190 (1970); *Hush-A-Phone Corp.* v. *United States*, 238 F.2d 266 (D.C. Cir. 1956); *Proposals for New or Revised Classes of Interstate and Foreign Message Toll Telephone Service (MTS) and Wide Area Telephone Service (WATS)*, 56 F.C.C.2d 593 (1975), *aff'd sub nom. North Carolina Utilities Commission* v. *FCC*, 552 F.2d 1036 (4th Cir. 1977), *cert. denied*, 434 U.S. 874 (1977); *Amendment of Section 64.702 of the Commission's Rules and Regulations (Second Computer Inquiry)*, 77 F.C.C.2d 384, *modified on reconsideration*, 84 F.C.C.2d 50 (1980), *modified on further reconsideration*, 88 F.C.C.2d 512 (1981), *aff'd sub nom. Computer & Communications Industry Ass'n* v. *FCC*, 693 F.2d 198 (D.C. Cir. 1982), *cert. denied*, 461 U.S. 98 (1983); *MTS and WATS Market Structure*, 81 F.C.C.2d 177 (1980); *Policy and Rules Concerning Rates for Competitive Common Carrier Services and Facilities Authorizations Therefor, First Report and Order*, 85 F.C.C.2d 1 (1980), *Second Report and Order*, 91 F.C.C.2d 59 (1982), *reconsideration denied*, 93 F.C.C.2d 54 (1983), *Fourth Report and Order*, 95 F.C.C.2d 554 (1983), *Fifth Report and Order*, 98 F.C.C.2d 1191 (1984), *Sixth Report and Order*, 57 Rad. Reg. (P&F) 2d 1391 (1985), *vacated*, *MCI Telecommunications Corp.* v. *FCC*, 765 F.2d 1186 (D.C. Cir. 1985).

In addition to the FCC, the Department of Justice has promoted a federal policy in favor of competition and open entry. In order to ensure fair competition in the provision of long distance services, information services, and in the manufacturing and distribution of terminal, switching, and transmission equipment, the Justice Department brought an antitrust suit against AT&T which resulted in the company's divestiture. *United States* v. *AT&T*, 552 F. Supp. 131 (D.D.C. 1982), *aff'd sub nom. Maryland* v. *United States*, 460 U.S. 1001 (1983).

The goals sought through the implementation of this national policy promoting technical innovation and network efficiency cannot be reached if telephone companies are threatened with inconsistent regulations that will deny adequate and timely capital recovery. There is a real relationship between adequate and timely capital recovery and the implementation of federal policy, contrary to the arguments of the appellant and petitioners. Brief of Appellant Louisiana Public Service Commission, *et al.* ("Louisiana Brief") at 13-15; Brief of Petitioners State of California and Public Utilities Commission of California, *et al.* ("California Brief") at 26 *et seq.* The receipt of adequate and timely capital recovery is, in fact, essential to the continued provision, by this nation's telephone carriers, of those modern, cost-efficient services and facilities so critical to the effectuation of federal policy. Petitioners fail to recognize the critical link between adequate capital recovery, efficient telephone company operations in a competitive environment, and the effectuation of federal policy. Local telephone companies play a pivotal role in the accomplishment of the federal policy objectives, which presume and require the existence of a modern, basic public switched network. Furthermore, local exchange companies are the only ubiquitous providers of telephone service within their franchised areas. Thus, the facilities of these companies are the vital link between new telecommunications service suppliers and the vast majority of consumers. Moreover, local companies are expected to provide many of the services, and much of the new equipment, now available through competition in the telecommunications marketplace. Therefore, to the extent that inadequate or untimely capital recovery renders local telephone carriers incapable of maintaining a modern public switched network or unable to serve as a competitive source for equipment and services, the accomplishment of the FCC's competitive policy objectives will be frustrated significantly.

Capital recovery is an important issue for telephone companies. Under the principles of rate base rate of return regulation which govern the provision of telephone service in the United States, telephone carriers are entitled to recover, from ratepayers, their legitimate business expenses plus a fair return on the property used in providing service to the public. *See, e.g.*, *Federal Power Commission* v. *Hope Natural Gas Co.*, 320 U.S. 591, 603 (1944). It is well settled that investors are entitled to recoup from ratepayers the full amount of their

investment in depreciable assets devoted to public service. *See Knoxville v. Knoxville Water, 212 U.S. 1, 10 (1909); Democratic Central Committee v. Washington Metropolitan Area Transit Commission*, 485 F.2d 786, 808 (D.C. Cir. 1973) *cert. denied*, 415 U.S. 935 (1974). This capital investment is recovered through annual depreciation charges designed to regain, over the service life of an asset, the entire amount paid by investors to purchase the plant. Federal Communications Commission, *Primer and Overview of Depreciation and Capital Accounting 3 (1980) ("FCC Depreciation Primer").*[3] These depreciation charges are based on the book cost (*i.e.*, original cost) of the asset. Such book depreciation when combined with the appropriate level of tax depreciation and the investment tax credit, must maintain a balance between the capital invested in the asset and that asset's economic value.[4] Only in this manner can it be assured that depreciation expense matches the revenue an asset generates permitting full recovery of the capital invested while the asset is in service.[5] Upon retirement, the original cost of a plant should be balanced by the total amount in the depreciation reserve and any net salvage realized at retirement. National As-

[3]Although not a dollar for dollar equivalence, as a consequence of the formula used to set carrier revenue requirements, depreciation expense affects the total amount of a carrier's net operating expense, the size of its rate base, and the actual return realized by the company. *See* Garfield and Lovejoy, *Public Utility Economics*, Chapter 8 (1964); National Telecommunications and Information Administration, *Issues on National Domestic Telecommunications: Directions for National Policy* 137 (1985) ("NTIA Report").

[4]*See*, Griffith and Robinson, *Economic Value and Capital Recovery: A Regulatory Model*, Pub. Util. Fort. 30 (July 11, 1985). The economic (market) value of an asset is the discounted value of the future revenues less the future expenses that an asset is expected to generate. In order to ensure proper economic depreciation, it is necessary that throughout the life of an asset, its net investment (gross investment less recovered capital) equals its then current market value. *Id.*

[5]This is an important protection for ratepayers, as well as investors, since ratepayers are required to reimburse investors for the cost of an asset even when the asset is underdepreciated at the time it is retired from service. When an asset is retired before it is fully depreciated, the loss is passed on to those ratepayers remaining. *See Democratic Central Committee*, 485 F.2d at 810.

sociation of Regulatory Utility Commissioners, *Public Utility Depreciation Practices* 36 (1968) ("NARUC Depreciation Manual").[6]

Capital recovery is essential to telephone company operations in the new environment because of its effect on a company's ability to provide adequate facilities and competitive services at reasonable rates. Since this was not true in the prior environment, capital recovery was generally sacrificed to keep subscriber rates low. *See, e.g., NTIA Report, supra* note 3, at 137-38; Joseph R. Fogarty, *Capital Recovery: A Crisis for Telephone Companies, a Dilemma for Regulators*, Pub. Util. Fort. 13, 14 (Dec. 8, 1983). This deferral was accomplished through the prescription of unreasonably long service lives,[7] and the use of depreciation methodologies such as the straight-line vintage group method ("SLVG"),[8] and the whole-life method.[9] This practice

[6]The depreciation reserve is the measure of the total acc[illegible] depreciation of depreciable assets still in service. Garfield and Lovejoy, *supra* note 3, at 95. Although California is correct that the reserve is not a fund, California Brief at 36, monies in an amount equivalent to the depreciation accruals flow into the general funds of the company and may be used for any purpose of the business including construction.

[7]This over-estimation of lives had the effect of reducing the companies' annual expenses while at the same time adding to the companies' rate bases and allowable earnings. Regulators benefited from this practice because annual revenue requirements were temporarily lower than they otherwise would have been, while companies also benefited because the continued growth on earnings resulting from the larger rate bases made the companies more attractive to investors. *NTIA Report, supra* note 3, at 138-40.

[8]Under the SLVG methodology, all the assets within a category of plant (*e.g.*, telephone cable) placed in service in a single year (vintage), regardless of variations in the useful lives of the plant, were classed together without respect to their individually projected lives and depreciated over the average useful life of the group. *See V[illegible]C*, 737 F.2d at 391.

[9]Whole-life methodology attempted to compensate for changes in estimation of plant service lives by calculating the annual depreciation charge that would have been appropriate if the currently estimated whole-life of the asset had been determined at the onset of the asset's life. Under this procedure, ratepayers are only charged costs equivalent to the *pro rata* portion of the total cost applicable to the time period. Current ratepayers are

(footnote continued)

was defensible in a fully regulated monopoly environment. In the absence of competition, investment was less at risk than it is today. Regulators and companies controlled the introduction of new technology and services, thereby assuring the eventual recovery of all investment. *NTIA Report*, *supra* note 3, at 138.

Such deferral is no longer possible. With constant technological innovation and the resultant development of competition, costs deferred in the past are not recoverable beyond the economic life of an asset since the revenues that an asset can generate are now dependent more on market conditions than on regulatory control.[10]

The timing of capital recovery and the use of accurate and consistent depreciation methods has become essential to telephone company operations. It is particularly important that in a competitive market, depreciation accounting reflect the economic reality of the company's total operations and total capital requirements to its customers, and investors, as well as to regulators. *Property Depreciation*, 83 F.C.C.2d 267, 281 (1980). Moreover, local telephone carriers must price competitively.[11] Depreciation is an important element in

charged neither costs attributable to past periods nor costs attributable to future time periods.

[10]According to NTIA:

> The growth of competition, the convergence of the communications and computer industries, deregulation, and the quickening progress of technology— which has reduced the economic life of many capital assets—all have combined to diminish the ability of regulators to maintain [the practices which were applicable in the monopoly environment] . . . . None of these practices is desirable under conditions of competition, especially where equipment and service innovations appear rapidly and failure to keep pace can handicap a vital industry.

NTIA Report, *supra* note 3, at 138.

This is a risk which is of great concern to the investment community and which has clearly negatively affected telephone company cost of capital even in the face of record earnings. *See, e.g.*, Hyman, *Utility Finances 1985*, Pub. Util. Fort. 17, 18 (Feb. 21, 1985).

[11]Local telephone carriers face increasing competition. Due to wide scale industry conversion to electronic digital (*i.e.*, computer based) switching

(footnote continued)

determining the price at which service can be offered by a regulated firm. *See 1983 Preemption Order*, 92 F.C.C.2d at 877. If competition is to be viable, it is necessary for prices to reflect depreciation expenses that are realistic for a competitive market. Most telephone plant is used interchangeably to provide interstate and intrastate communications service and as a result supply and demand for this plant is determined by service demand inputs from both jurisdictions. *Id.* at 271-272. Consequently, it is no longer possible to separate the interstate and intrastate components of depreciation if the public is to enjoy the benefits of competitive pricing.

Depreciation represents a major source of funding for the extremely capital intensive telephone industry. This role will increase as external capital becomes more expensive for telephone companies and as the companies are forced to accelerate their network modernization programs in order to meet competition.[12] Again, given the interchangeability of plant, it is not feasible to divide capital recovery into interstate and intrastate components if federal policy is to be achieved.

equipment during the past several years and the recent introduction of fiber optical transmission technology, the industry's technology base is no longer static. Advances in digital switching technology have actually reduced the cost of switching capacity. As the digital switching technology continues to evolve, further reductions in the cost of replacement capacity can be anticipated. This declining replacement cost function permits potential competitors to purchase operating capacity at a lower cost per unit than the telephone companies' embedded cost per unit, as well as to price these services lower than telephone company offerings. As a result, natural barriers to competition at even the local exchange level are falling. Competitive pricing is required therefore not as a means of permitting local carriers to "drive out new entrants to their markets." California Brief at 37, but as a means of ensuring the fullest degree of competition in the marketplace in order to achieve federal policy objectives.

[12]For example, in 1976, depreciation funds represented 46.5% of construction expenditure funds sources. Bolter & Irwin, *Depreciation Reform-A Crucial Step in Transforming Telecommunications to a Free Market* 93 (1980). In 1984, total telephone industry depreciation expense was $11,816,343,000. This represented 66.4% of total industry gross addition to plant which amounted to $17,774,072,000. United States Telephone Association, *Telephone Statistics 1985* 17, 20 (1985).

At the same time that timely depreciation has become essential to telephone company operations, the current net book value of much plant in service unfortunately is now substantially above its market or economic value as a consequence of technological change and increased competition.[13] In the aggregate, the telephone industry now has approximately a $26 billion deficiency in its depreciation reserves.[14] This reserve deficiency is equivalent to approximately 41% of the companies' equity. The prospect that this enormous amount may never be recovered represents a serious threat both to the telephone industry and to its customers.[15]

Given the importance of capital recovery to total telephone company operations and the sizeable depreciation reserve deficiency, the utilization of proper and uniform depreciation rates and methods at both the interstate and intrastate levels has become "critical if the proper incentives are to be created to insure that the marketplace will function efficiently to bring the benefits of competition to the ratepayers of this country." *1983 Preemption Order*, 92 F.C.C.2d at 874. Improper accounting and depreciation rules would deprive the public of the benefits of advances in communications and serve to "stifle innovation and inhibit the introduction of new technology." *Property Depreciation*, 83 F.C.C.2d at 281. Varying state accounting methodologies which do not accurately reflect both the current measure of the consumption of capital and make provision for the costs of the capital unrecovered through depreciation charges would result in such inadequate and untimely capital recovery. *Id.* at 271-72. This improperly timed capital recovery would prevent telephone companies from offering their services at competitive prices, deprive the companies of badly needed internally generated funds, discourage investment

[13]The economic life of many telephone company capital assets has been reduced as a result of technological change and competition. Even though this plant may be serviceable from an engineering standpoint, from an economic standpoint replacement is required in order to avoid unreasonably high rates and to ensure the availability of new services. The value of telephone plant has therefore diminished faster than it would in the monopoly environment and faster than the carriers have been permitted to depreciate.

[14]Gold, *The $26 Billion Solution*, Forbes 40-41 (July 29, 1985).

[15]*NTIA Report*, *supra* note 3, at 142.

in the companies, and increase their overall cost of capital. Underdepreciation would also constrain the introduction of new technology and conversion to new plant, and restrict the maintenance and improvement of existing services and the provision of new services.[16]

Prevented from providing modern services at reasonable rates, the telephone companies will find their larger customers bypassing the local telephone network.[17] Faced with uncertain outside capital markets and a corresponding inability to generate sufficient funds internally, the companies would be forced to delay plant modernization and load even higher depreciation expenses on remaining small business and residential customers.

[16]*See* Fogarty, *supra*, at 14-15. *See also* the FCC's *1983 Preemption Order* where it concluded that "it is possible that improper capital recovery could delay or prevent modernization which would add to the costs borne by ratepayers and could, ultimately, threaten carriers' ability to fully recover their invested capital." 92 F.C.C.2d at 877. This fact was recognized at least in the past by petitioner NARUC:

> The regulatory body prescribing [depreciation] rates is thus confronted with a decision which affects both the short-run and the long-run interest of the customer who pays rates for utility service. If the commission consistently prescribes depreciation rates below the lower limit of the zone of reasonableness, this results immediately in lower revenue requirements. But in the long run the requirements for income taxes and return more than offset the apparent saving in depreciation expense, so that rates for service must be higher than if the depreciation rates had been more adequate. If the depreciation rates are set so low as to fail to repay the capital invested in a group of property by the end of its service life, confiscation takes place or the unpaid cost remains in the rate base permanently. If, on the other hand, the regulatory body takes a liberal view of the probable service life of the property and establishes depreciation rates toward the middle or high side of the zone of reasonableness, rates for service will be higher in the short run, but in the long run may be lower.

NARUC Depreciation Manual, *supra*, at 33.

[17]"Bypass" has been defined as the use of communications facilities or services (video, voice, or data) which circumvent the public switched network. *MTS & WATS Market Structure*, 93 F.C.C.2d 241, Appendix F

(footnote continued)

It was in response to this clear threat to its policy of promoting network efficiency and modernization that the FCC adopted the *Property Depreciation* order in Docket No. 20188. Although the Commission had inherited the ICC's plenary authority over telephone company capital recovery, *1983 Preemption Order*, 92 F.C.C.2d at 870-73, the exercise of its full authority was unnecessary prior to the development of the present environment. However, in August 1980 the FCC Staff determined that a "substantial deficiency" existed in telephone carrier depreciation reserves. *FCC Depreciation Primer, supra*, at 32. Three months later, after a seven year investigation, the FCC adopted regulations approving new depreciation methodologies. The FCC's action was based on its conclusion that telephone plant service lives had shortened substantially over previous estimates and that as a result, past allocations of capital recovery had been inadequate. *Property Depreciation*, 83 F.C.C.2d at 289-91. Moreover, the FCC found that if corrective action was not taken, future carrier reserves would not be adequate. *Id.* at 289-90. The Commission determined that to ensure that telephone carriers received capital recovery which more accurately matched consumption, it would be necessary to approve the use of the equal life group (ELG)[18] and remaining life[19] depreciation

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(1983). In a recent study, USTA determined that 35.9% of the telephone industry's monthly access revenues, 40.5% of its business customer base, and 21% of its residential customer base were vulnerable to bypass. United States Telephone Association, *Bypass Study* 2 (Oct. 5, 1984).

[18] ELG, or the unit summation method, is a method which groups plant by combining all units within each vintage group which share an equal life expectancy and is designed to depreciate 100 percent of the original cost of each plant unit over its life. *Depreciation Rates*, 96 F.C.C.2d 257, 259 (1983). In contrast, SLVG makes no attempt to adjust depreciation to allow for reserve surpluses or deficits resulting from the cumulative over or underestimation of life and salvage factors. It is a form of decelerated depreciation which shifts a disproportionate amount of the capital recovery burden to longer-lived plant. *See FCC Depreciation Primer, supra*, at 15-16.

[19] The remaining life methodology approved by the FCC is designed to distribute the unrecovered cost of a group of assets over its estimated average future life expectancy. *Property Depreciation*, 83 F.C.C.2d at 280. The remaining life method differs from whole-life methodology in that the method attempts to ensure that the costs of an asset are recovered during its life time while the whole-life method does not. Although the whole-life method arguably worked in the precompetitive environment, it failed as competition

(footnote continued)

methods to replace the previously employed SLVG and the whole-life depreciation methods. *1983 Preemption Order*, 92 F.C.C.2d at 876. The FCC concluded that the use of these methods: (1)would enhance the companies' cash flow and present a more accurate and objective financial picture of the companies' operations and capital requirements and (2)would promote a substantial federal interest by making possible the accomplishment of the Commission's mandate under Section 1 of the Communications Act through the encouragement of innovation and the introduction of new technology. *Id.* at 878 (citing 47 U.S.C. § 151).

As a consequence, adequate and timely capital recovery is essential to the implementation of the national policy of promoting the efficient operation of the interstate network if continued technological innovation is not to be stiffled and the introduction of new technology not to be inhibited.

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took root because it was no longer possible to fully compensate telephone companies for errors in the estimates of service lives. *Id.*

II. UNDER ESTABLISHED LAW FCC PREEMPTION OF INCONSISTENT STATE DEPRECIATION PRESCRIPTIONS IS VALID

Subsequent to its adoption of the *Property Depreciation* order and faced with mounting state refusal voluntarily to adopt complementary depreciation rates,[20] the Commission reluctantly determined that divergent state depreciation rates and methodologies would have a significant negative impact on telephone company operations because of the tremendous amount of plant involved, and would, as a result, frustrate the accomplishment of federal objectives. *1983 Preemption Order* at 879-80.[21]

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[20] Many state regulators opposed the capital recovery reform measures embodied within Docket No. 20188 from its inception. *See Property Depreciation*, 83 F.C.C.2d at 278-79. These same regulators have, in public forums, espoused their general belief that the depreciation methods available to the telecommunication industry prior to Docket No. 20188 were sufficient for achieving complete captial recovery. Several of these same State Commissions ultimately refused to implement the depreciation method reforms ordered by the FCC in Docket 20188. *See 1983 Preemption Order*, 92 F.C.C.2d at 877 n.14. It seems likely that if FCC authority is overturned these same commissions will return to the archaic and obsolete methods applied before the improvement ordered in the *Property Depreciation* order.

[21] Petitioners have misconstrued the significance of the Commission's *1982 Preemption Order* which was reversed in the *1983 Preemption Order*. *See, e.g.*, Louisiana Brief at 41. The *1982 Preemption Order* was adopted by a bare majority of the Commission. Moreover, two of the dissenting Commissioners strenuously argued that the FCC did have the authority to preempt the states, that it had intended to preempt the states, and that such preemption was required because state objections threatened to imperil and frustrate "important interests of national communications policy." *1982 Preemption Order*, 89 F.C.C.2d at 1109-11 (quoting *North Carolina Utilities Commission* v. *FCC*, 552 F.2d at 1047). Further, implicit in the majority's reasoning was the assumption that "most state commissions have followed most accounting and depreciation procedures prescribed by this Commission in the past," *id.* at 1097, and that as a result, state regulation was reconcilable with federal policies. 89 F.C.C.2d at 1108. However, on reconsideration of its legal authority, and faced as well with the potential frustration of its policy resulting from inconsistent state regulation, a unanimous Commission adopted the *1983 Preemption Order* at issue here.

The broad authority of the FCC to preempt state regulation which is inconsistent or in conflict with the achievement of federal regulatory objectives has been upheld frequently. *See, e.g.*, *United States* v. *Midwest Video Corp.*, 406 U.S. 649 (1972); *United States v. Southwestern Cable Co.*, 392 U.S. 157 (1968). The most recent example is the Court's unanimous decision in *Capital Cities* which held emphatically that, "if the FCC has resolved to pre-empt an area of... regulation and if this determination 'represents a reasonable accommodation of conflicting policies' that are within the agency's domain, we must conclude that all conflicting state regulations have been precluded." *Capital Cities*, 104 S. Ct. at 2701 (quoting *United States* v. *Shimer*, 367 U.S. 374, 383 (1961)).

The Court's decision in *Capital Cities* arose in a context directly analogous to the present case, *i.e.*, where a state's conflicting regulatory action interfered with the FCC's efforts to establish a uniform national telecommunications policy—in that case, with respect to cable television. 104 S. Ct. at 2703. Similarly, state actions under scrutiny here squarely conflict with federal policies governing the most essential of our telecommunications resources, the telephone industry. As was true in the Oklahoma case, the effect of the state regulation at issue here is to subject communications service providers to inconsistent state and federal orders. Moreover, the states' actions impede the FCC's efforts to implement a consistent and effective national policy. Thus, it is entirely appropriate in this case to apply the Court's mode of analysis employed in *Capital Cities*, and to reach the same conclusions.

In *Capital Cities*, the Court expanded upon the reasoning applied in *Fidelity Federal Savings & Loan Ass'n* v. *De La Cuesta*, 458 U.S. 141 (1982), where it had held that state regulation is superseded when the federal agency entrusted with administering a Congressional act intended to preempt conflicting state regulation and such preemptive action was within the scope of the agency's authority. *Id.* at 154. In applying this principle, the Court's resolution of the federal preemption question in *Capital Cities* rested upon affirmative findings with respect to five discernible factors: (1) whether the FCC had expressed its clear intent to preempt the area of regulation in question, *Capital Cities*, 104 S. Ct. at 2700-02; (2) whether the FCC's preemptive action furthered an important federal interest, fell within its statutory

grant of authority, and was aimed at the achievement of its statutory responsibilities and objectives, *Id.* at 2700-01, 2703-04, 2702-08; (3) whether the FCC's decision to preempt conflicting state regulation reflected a "pragmatic effort to harmonize state and federal powers' within the context of the issues and interests at stake," *Id.* at 2708 (quoting *California Retail Liquor Dealers Ass'n* v. *Midcal Aluminum, Inc.*, 445 U.S. 97, 109 (1980)); (4)whether the state regulation under scrutiny conflicted with specific federal regulations or rulings, *Id.* at 2703-05; and, (5)whether the accomplishment of FCC regulatory policies and statutory goals was frustrated by the conflicting state regulation at issue, *Id.* at 2705-09. Analysis of the FCC preemptive action at issue here, in light of these five factors, makes it clear that it is appropriate to preclude the states from prescribing depreciation rates and practices which conflict with the FCC's prescriptions.

A. The FCC Has Unambiguously Expressed Its Intent To Preempt Inconsistent State Regulation Of Depreciation Rates And Practices

There is no doubt concerning the FCC's intent to preempt inconsistent state regulation governing depreciation methods and classes of depreciable property—that intent was explicit and unmistakable. *VSCC*, 737 F.2d at 393. Recognizing that uniform application of capital recovery policies is necessary to its goal of an efficiently functioning competitive telecommunications marketplace, the FCC unequivocally held that, "we find that this Commission's depreciation policies and rates, including the expensing of inside wiring, preempt inconsistent state depreciation policies and rates." *1983 Preemption Order*, 92 F.C.C.2d at 880. The Commission's unambiguous expression of its intention to preempt clearly distinguishes this case from the *Hillsborough* case relied on by the petitioners. *Hillsborough County* v. *Automated Medical Laboratories, Inc.*, 105 S. Ct. 2371 (1985) (which involved an ordinance of Hillsborough County, Florida).

B. Federal Preemption Is Justified Because It Furthers An Important Federal Interest, Falls Within The Scope Of The FCC's Statutory Grant Of Authority And Advances The FCC's Statutory Goals

As the Court in *Fidelity Federal* stressed, "[p]reemption may be either expressed or implied, and 'is compelled whether Congress' command is explicitly stated in the statute's language or implicitly contained in its structure and purpose.'" *Fidelity Federal*, 458 U.S. at 152-53 (quoting *Jones* v. *Rath Packing Co.*, 430 U.S. 519, 525 (1977)).

Analysis of the Commission's action in terms of the factors used in *Capital Cities*, 104 S. Ct. at 2700-01, 2701-04, 2705-06, compels the conclusion that FCC power to preempt conflicting state depreciation regulation is implicitly conferred upon the Commission pursuant to its broad statutory mandate under Section 1 of the Communications Act *(see VSCC*, 737 F.2d at 390, 394-96 (FCC's broad jurisdiction under Section 2 of the Act); *see also North Carolina Utilities Commission* v. *FCC*, 537 F.2d 787, 792-96 (4th Cir. 1976), *cert. denied*, 429 U.S. 1027 (1976) ("*NCUC I*"), and the FCC's express authority over depreciation, Section 220(b).[22] While the Communications Act contemplates complementary federal and state regulation in limited circumstances, *see* 47 U.S.C. 152(b), the FCC is given ple-

[22]FCC power to preempt conflicting state regulation of depreciation is also explicitly set forth in Section 220(b) of the Communications Act of 1934, 47 U.S.C. 220(b). Section 220(b) mandates preemption in plain, unequivocal language: that the Commission "shall" make depreciation prescriptions as to classes of property and rates of depreciation, and that carriers "shall not" charge to operating expenses any depreciation charges that are different from those prescribed by the Commission. The FCC found:

> Taken as a whole, the language of Section 220 appears clearly to preempt the states in connection with depreciation expense determinations and the related accounting. The language strongly implies that the states may not depart from depreciation rules prescribed by the FCC unless the Commission in its discretion allows them to do so. Otherwise, the federal statute would govern state depreciation practices in form only. . . .

1983 Preemption Order, 92 F.C.C.2d at 869-70.

nary and comprehensive jurisdiction over interstate and foreign communications services and facilities and the terms and conditions upon which such services and facilities are offered to the public. As a result, the courts have repeatedly recognized that FCC regulations preempt any contrary state regulations where the efficiency of the national communications network is at stake. *VSCC*, 737 F.2d at 390. As the Court of Appeals for the District of Columbia Circuit recently held, "[i]f the [Communications] Act's goal of providing uniform efficient service is ever to be realized, the Commission must be free to strike down the costly and inefficient burdens on interstate communications which are sometimes imposed by state regulation." *National Association of Regulatory Utility Commissioners* v. *FCC*, 746 F.2d 1492, 1501 (D.C. Cir. 1984) ("NARUC"). *See also Computer & Communications Industry Ass'n* v. *FCC*, 693 F.2d 198, 214 (D.C. Cir. 1982), *cert. denied*, 461 U.S. 938 (1983) ("CCIA"); *North Carolina Util. Comm'n* v. *FCC*, 552 F.2d 1036 (4th Cir. 1977), *cert. denied*, 434 U.S. 874 (1977) ("NCUC II"). It is clear, moreover, as Judge Burger stated in *General Telephone Company* v. *FCC*, 413 F.2d 390, 401 (D.C. Cir. 1969) *cert. denied*, 396 U.S. 888 (1969), that "fifty states and myriad local authorities cannot effectively deal with bits and pieces of what is really a unified system of communication."

The Commission adopted depreciation "policies that will engender a dynamic, efficient telecommunications marketplace with services being provided at reasonable prices." *1983 Preemption Order*, 92 F.C.C.2d at 877. Thus, as the Fourth Circuit held in the *VSCC* decision, "the regulatory action taken by the FCC was also within its authority to ensure efficient operation of the interstate telephone network." *VSCC*, 737 F.2d at 394. Moreover, "the FCC's decision to preempt inconsistent state depreciation practices emerges as a reasonable one, designed to foster the statutory goal [mandated by Section 1 of the Act] of an efficient nationwide telecommunications service." *VSCC*, 737 F.2d at 396.

C. The FCC's Decision To Preempt Conflicting State Depreciation Practices And Rates Represents A Reasonable Accommodation Of Federal And State Powers And Interests

In its *1983 Preemption Order*, the FCC carefully analyzed the

relationship between its authority to prescribe depreciation rates and practices and the powers granted the states under the Communications Act to regulate intrastate communications. Observing that "we do not seek controversy unless it is necessary to protect vital federal interests," 92 F.C.C.2d at 874, and relying on established law interpreting its statutory charter, the FCC concluded that federal preemption of inconsistent state depreciation methods was consistent with the structured dualism between federal and state powers under the Act. *See Capital Cities*, 104 S.Ct. at 2707-08 (quoting *California Retail Liquor Dealers Assn.* v. *Midcal Aluminum, Inc.*, 445 U.S. 97, 109 (1980)).[23] In its pragmatic effort to harmonize federal and state powers under the Communications Act, the FCC was upheld by the Fourth Circuit in rejecting the same argument as is currently under consideration, that under Sections 2(b)(1) and 221(b) of the Act, 47 U.S.C. §§ 152(b)(1) and 221(b), the states alone have the right to prescribe depreciation rates for intrastate regulatory purposes. The Commission ruled that the "setting of depreciation rates is not an essentially local incident or practice" but, rather, "has substantial effects upon the administration and development of the interstate telephone network." *1983 Preemption Order*, 92 F.C.C.2d at 875 (footnote omitted). The FCC stressed that while the states have an interest in preserving their authority over intrastate ratemaking, the federal interest in the creation of an efficient, competitive nationwide communications marketplace was paramount, especially since the FCC's prescription of depreciation left intact the remainder of the states' ratemaking authority.[24]

[23] Throughout the course of the depreciation proceedings, the FCC attempted to harmonize federal and state interests. *See, e.g.*, *1982 Preemption Order*, 89 F.C.C.2d at 1097. Because of state resistance, the FCC was forced to take preemptive action. *See VSCC*, 737 F.2d at 394-95.

[24] The states have retained the most important aspects of their ratemaking function: the power to approve rates, create subsidies, and exercise control over the rate base and rate of return. 92 F.C.C.2d at 874-76. The state commissions have actually conceded this point below where they stated that:

> the preemption order affects neither the myriad of other factors affecting the total revenue requirement, which must be derived from the aggregate of individual prices, nor the prices for individual services (rate design).

Brief of Petitioner Virginia State Corp. Commission at 37, *VSCC* v. *FCC*, 737 F.2d 388 (4th Cir. 1984) (joined *inter alia* by the Ohio, Florida, and California commissions).

Thus, as the Court held in *Capital Cities*, "[w]hen this limited interest is measured against the significant interference with the federal objective"—i this case, of ensuring the proper development of the nationwide telecommunication network—"it is clear that the state's interest is not of the same stature as the goals identified in the FCC's rulings and regulations." 104 S.Ct., at 2709. The Fourth Circuit's conclusion that the FCC action was a reasonable accommodation of federal and state concerns, *VSCC*, 737 F.2d at 394-95, brings this case squarely within the logic of *Capital Cities* and must lead to the same result— upholding federal preemption.

D. The Accomplishment Of FCC Regulatory Objectives Is Frustrated By Inconsistent State Regulation Of Depreciation

Inconsistent state regulation of depreciation rates and methodologies would create an intolerable tension and undermine the achievement of an important federal policy the goal of which is the development of "a dynamic, efficient telecommunications marketplace with services being provided at reasonable prices." *1983 Preemption Order*, 92 F.C.C.2d at 877. Given the importance of capital recovery to the accomplishment of federal objectives, continuation of the past policies of deferred recovery and federal acquiescence to inconsistent state regulation are not appropriate. Since complete and timely recovery of capital cannot be assured except through the use of consistent methodologies, conflicting regulation adopted by many of the states would impede the prompt recovery of capital, result in a worsening of the capital recovery reserve deficiency problem and stand as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress. *See VSCC*, 737 F.2d at 393.

Interstate and intrastate depreciation methodologies are no longer separable. As the Court of Appeals emphasized in the *VSCC* opinion:

> While it may be true that the effects of depreciation policies are more attenuated than the very direct effect produced by physical connection of equipment to interchangeable lines, *it cannot be said that depreciation policies are "separable from" interstate communications. Indeed, the conduct and development of interstate communications would undoubtedly be affected by the states' imposition of depreciation policies that slowed capital recovery and innovation.*

Id. at 395 (emphasis added).

Consequently, California's argument that there is no substantial conflict between inconsistent federal and state regulation of depreciation rates and methodologies must be dismissed. *See California Brief* at 31-34.[25] Since approximately 75 percent of exchange plant is allocated to the intrastate jurisdiction,[26] if, as a result of inadequate state depreciation rate prescriptions, "that large amount of equipment investment should fail properly to reflect its true, rapid depreciation, interstate service would then suffer the effects of delayed innovation." *VSCC*, 737 F.2d at 395; *see also, 1983 Preemption Order*, 92 F.C.C.2d at 876.[27] Moreover, state action attempting to prevent carriers from

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[25]California's arguments that state regulators can be depended upon to ensure that companies receive adequate capital recovery, California Brief at 36, and that past state depreciation policies (albeit in conjunction with federal policy) in no way discouraged technological innovation, *id.* at 37, must also be dismissed as not reflective of historical reality. *See, e.g., NTIA Report* at 136-39. The fact that FCC action was necessary belies this argument.

[26]The proportion of the plant allocated to the intrastate jurisdiction is not significant in determining whether the FCC possesses the authority to preempt. A similar proportion of customer premises equipment had been allocated to the intrastate jurisdiction using similar procedures. *Second Computer Inquiry*, 77 F.C.C.2d at 441-42. However, in the face of overriding federal policy such allocation did not thwart federal preemption. *See CCIA*, 693 F.2d at 214.

[27]NTIA reached a similar conclusion:

> There is substantial potential for frustration of Federal policies should states successfully resist FCC or court mandates on depreciation recovery for future investment. ... Changes in depreciation policy are crucial to the ability of the local telephone companies to meet competition. New competitors do not have large depreciation reserve deficiencies. Most of them are unregulated and can select the most beneficial depreciation schedules allowed by Federal tax laws. By failing to make reasonable depreciation prescriptions, state regulators stimulate and strengthen competitive threats to the their [sic] local exchange companies.

NTIA Report, *supra* note 3, at 139-40.

utilizing FCC depreciation prescriptions would place substantial burdens on carriers and impair their ability to raise the investment capital necessary to fully compete in the evolving competitive telecommunications marketplace. *See 1983 Preemption Order*, 92 F.C.C.2d at 877. Such results would clearly "stand as an obstacle to the accomplishment and execution of the full purposes and objectives" of federal policy. *VSCC*, 737 F.2d 393 (quoting *Fidelity Federal*, 458 U.S. 141 (1982)). Further, as was demonstrated by appellant Louisiana, the federal-state conflict is both real and significant. Louisiana Brief at 16-17. Thus, to allow the states to prescribe depreciation methodologies inconsistent with those prescribed by the FCC would have an undesirable hindering effect and must, therefore, be considered "barred by the Supremacy Clause." *Capital Cities*, 104 S. Ct. at 2709.

III. FEDERAL REGULATORY POLICY WOULD BE THROWN INTO DISARRAY IF THE COURT FINDS THAT FCC PREEMPTION IS IMPROPER IN THIS CASE

The Commission in recent years has been forced to preempt state regulation in order to safeguard its efforts to promote the provision of modern, efficient nationwide communication service at reasonable rates and the provision of new technologies and services to the public. The Courts of Appeals have consistently upheld FCC preemption, including preemption affecting intrastate rates, where important matters of federal policy are involved. For example, the Court of Appeals upheld FCC preemption of state regulation of enhanced telecommunications services, as a result of which state commissions are precluded from setting rates for these services. *See CCIA*, 693 F.2d at 209-11. Such preclusion also affected local service rates by preventing the use of enhanced service revenues to subsidize local rates. Nonetheless, the Court of Appeals found the FCC's actions to be a valid exercise of the agency's statutory authority which furthered important federal policy goals.

In many of the cases where the FCC's authority to preempt state regulation has been challenged, the states have offered an argument identical to that presently under consideration, *i.e.*, that the FCC's

action is precluded by Section 2(b) of the Communications Act, 47 U.S.C. § 152(b), which reserves to the states the authority to regulate intrastate rates.[28] The Courts have consistently rejected this argument.

For example, in *CCIA* the District of Columbia Circuit held that Section 2(b) did not bar federal preemption merely because preemption of state regulation of terminal equipment and enhanced services affected state ratemaking. There, the FCC had determined that, in order to establish a competitive market for customer premises equipment that was used for both interstate and intrastate purposes, the equipment had to be severed from transmission rates and removed from tariff regulation at both federal and state levels. 693 F.2d at 215.

Clearly, the severance of equipment from transmission rates had a tangible impact on ratemaking, since revenues from terminal equipment could be used to subsidize local rates. The Court of Appeals recognized, however, that the FCC's action was necessary to the furtherance of its policy goals and rejected the states' argument that preemption was improper, holding that there is no statutory basis for distinguishing between ratemaking and other regulatory functions in drawing the lines between federal and state authority. *CCIA*, 693 F.2d at 216.

Even in instances which impinge upon the states ratemaking authority, arguably to a more significant degree than in the situation under scrutiny here, where depreciation affects only a single element in the ratemaking equation, the Courts of Appeals have consistently upheld federal preemption.[29]

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[28] Section 2(b) of the Act provides in pertinent part, that the FCC has no jurisdiction "with respect to (1) charges, classifications, practices, services, facilities, or regulations for or in connection with intrastate communication service by wire or radio of any..." 47 U.S.C. 152(b)(1).

[29] *See, e.g.*, *NCUC I*, 537 F.2d 787 (preemption of inconsistent state regulation of terminal equipment interconnection affirmed); *NCUC II*, 552 F.2d 1036 (FCC terminal equipment registration program affirmed); *Puerto Rico Tel. Co.* v. *FCC*, 553 F.2d 694 (1st Cir. 1977) (FCC declaratory order that although Puerto Rico Telephone Company was a "connecting" carrier it was bound by interstate tariff affirmed); *New York Telephone Co.* v. *FCC*, 631 F.2d 1059 (2d Cir. 1980) (FCC jurisdiction over local exchange service

To determine, as urged by the appellant and petitioners, that the FCC's preemption of depreciation rates is an improper encroachment upon the states' ratemaking authority, would place in question the jurisdictional premises of the FCC's ruling in the terminal equipment case and those other areas where the FCC's policy made it necessary to preempt contrary state regulation. Thus, a result that FCC preemption is not appropriate here, where the FCC's actions have an indirect and attenuated impact on state ratemaking authority (VSCC, 737 F.2d at 395), would throw the entire new scheme of federal regulation into disarray. States once again will assert authority over telecommunications equipment and service offerings which have been deregulated for a substantial period of time.

Such a result would have a negative impact on the future development of federal policy. It would suggest that the FCC is precluded from implementing policies aimed at procuring benefits for telecommunications consumers nationwide if, in so doing, the FCC affects even slightly intrastate revenue requirements. Under its Section 1 mandate, the FCC is striving to establish the structure for a modern nationwide telecommunications network. To do so, the Commission must be able to implement a cohesive national regulatory scheme. A Court decision reversing the Fourth Circuit's holding would severely impair the development of a modern nationwide system of communications—an especially egregious result in light of the disruptions already experienced since divestiture of AT&T—an act which has created an even greater need for a cohesive national regulatory policy governing the future of the telecommunications industry. Thus, the Court must consider its action in this case in terms of that decision's impact on the FCC's ability to oversee the development of one of this nation's most vital resource—telecommunications.

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when used in connection with interstate foreign exchange and common control switching arrangement services affirmed); *Fort Mill Telephone Co.* v. *FCC*, 719 F.2d 89 (4th Cir. 1983) (FCC authority over terminal equipment interconnection upheld); *NARUC*, 746 F.2d 1492 (FCC authority over use of intrastate WATS service to complete interstate communications affirmed); *California* v. *FCC*, 567 F.2d 84 *(D.C. Cir. 1977)*, *cert. denied*, 434 U.S. 1010 (1978) (FCC jurisdiction over regulation of foreign exchange and common control switching arrangement facilities affirmed, where facilities used for both interstate and intrastate service).

CONCLUSION

The court below, properly applying the standards established by this Court, correctly determined that the FCC acted within the scope of its authority in preempting inconsistent state regulation of depreciation practices and rates. Both precedent and national policy dictate that the lower court be affirmed.

Respectfully submitted,

Jack E. Herington
General Counsel
United States Telephone
Association
1801 K Street, N.W.
Washington, D.C. 20006
(202) 872-1200

Joseph R. Fogarty
H. Russell Frisby, Jr.
Marcia Spielholz

Weil, Gotshal & Manges
1101 Fourteenth Street, N.W.
Washington, D.C. 20005
(202) 682-7000